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VOL. XXIV

June • 1954

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Society and Editorial Offices: 677 Fifth Avenue, New York 22, N. Y.

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AN ADIRONDACK VIEW

Pay. This is the time of year when the seniors kiss alma mater good-bye and commence to save the world—or at least commence to save dad's bank account. The new grad's problem, and it is not simple, is to get and accept the right job.

Today, the getting part is fairly simple, but which one to accept is complex. One dad suggested to a son that the things to consider were:

- Location—housing, schools, climate, local government and distance from friends and parents.
- The nearness of the work to the son's particular training, interests, natural abilities and peculiarities.
- The reputation and habits of the employer.
- "And the pay comes last," provided it is up to normal.

And the son did so consider and—lo! the preferred job came through with pay that led all the rest!

LEONARD HOUGHTON, C.P.A.
"Adirondack Chapter"

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CORRESPONDENCE

To the Editor of *The New York Certified Public Accountant*:

I have read the article "Esse Quam Videri" by Mr. Byrnes in the May issue of "The New York Certified Public Accountant" and feel that it is not entirely fair to the profession.

Bankers and other credit suppliers, when they receive reports with qualified opinions have, in my judgment, an obligation to inform the credit seekers that they require an audit which will permit the accountant to express an unqualified opinion.

It happens on occasion that clients want the scope of their examination limited; where this occurs the auditor

is left with no other alternative than to present a qualified opinion.

There is also an obligation on the part of the practitioner, before commencing an audit, to determine the adequacy of the internal controls and procedures and to plan his audit program so as to test those areas where weaknesses exist. If this were given due consideration and appropriate procedures adopted, it might be possible for the practitioner to give a more informative report and thus satisfy the client and the credit grantors.

Very truly yours,

CHARLES HECHT

New York, N. Y.



Note by Mr. Byrnes:

My little article was based on a financial editorial in the New York World-Telegram and Sun of November 25, 1953, and Mr. Carey's statement in the last paragraph on page 2 of the December, 1953, C.P.A. Bulletin

of the American Institute of Accountants. I am very jealous of the reputation of the profession, and my little articles are intended to help maintain its high rank in the public esteem. Comments are always very welcome.

THOMAS W. BYRNES



CORRECTION

The article entitled, "*Esse Quam Videri*", which appeared on page 337 of our May, 1954, issue contained an unfortunate typographical error which obscured the meaning of the first sentence of the second paragraph thereof. This sentence should have read, "Before the fault finding becomes too general, . . ."

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Book Reviews

Cost Accounting

By John G. Blocker and W. Keith Weltmer. MCGRAW-HILL BOOK COMPANY, INC., New York, 1954. Pages: XVI, 623; \$6.50.

The third edition of Blocker's *Cost Accounting*, now the joint work of Blocker and Weltmer, illustrates the trend in cost accounting which has been visible for some time and which all recent texts in this field have exhibited to a greater or lesser extent. The emphasis is on managerial aspects of cost accounting including those areas in which management must deal with choices between alternative courses of action.

Basically, the new edition follows the plan of the previous edition with some modifications. A number of chapters have been condensed; that is, the same material has been included in fewer chapters. This is true notably in Parts I and II. Part I, dealing with fundamentals, in the second edition covered ten chapters which have now been condensed to eight. Part II presents various cost systems, including job order, process, joint and by-products, estimating, and standard. It, too, has undergone some condensation. Part III, involving distribution and administrative costs, seems to have changed but little. The most notable changes have been in Part IV. The chapters on cost accounting in the retail, financial, and governmental fields have been eliminated. The chapter on joint and by-products has been moved to Part II. This leaves only two chapters in Part IV, one of which is new: cost analysis for management decisions and the new chapter on cost and income charts.

It seems to this reviewer that the changes made in the new edition are all to the good. There is, of course, the danger that, in stressing matters of managerial policy, the mechanics of cost accounting and control may suffer. Somewhere a proper balance must be struck.

So far as the management phase is concerned, the book has made a valiant attempt to keep up with the times. Chapter XVIII on analysis, investigation, and disposition of variances is good in that it attempts to get behind the variances to the underlying reasons that produced them.

Chapter XXIII on cost and income charts is disappointingly short. The emphasis is on the construction of the break-even chart, rather than general analysis. This chapter, together with the preceding one on cost analysis for management decisions, does present the most recent advances in managerial cost accounting. However, direct costing is merely hinted at, being mentioned in passing and dismissed by a footnote reference. It is in this field of managerial costing that the most fruitful research is possible.

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Book Reviews

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In summary, the condensations, eliminations, and additions of material together with some change in emphasis have combined to produce a thoughtful and mature book on cost accounting.

THEODORE LANG

Graduate School of Business
Administration
New York University, N. Y.

How to Save Taxes Through Proper Accounting

By Jackson L. Boughner. PRENTICE-HALL, Inc., New York, 1954. Pages: 295 + xv; \$5.95.

There have been many works on tax-saving, but this one is designed for the business man, the employee-bookkeeper, or the attorney whose experience with taxes is casual.

The work is designed for such use in that the author has written with restraint and avoided technicalities. The result is an easy readable style which should hold the interest of the lay reader and at the same time open a whole vista of tax-saving possibilities.

In the true sense of the word this is not a "How to" book. While there are ample references to the Internal Revenue Code, Regulations and cases, professional advice will be needed to properly implement the ideas and suggestions advanced.

What the book can do is to convince the non-practitioner of the savings possible through tax study and advice prior to the initiation of transactions or the determination of business policy. In addition it will also serve as a review of tax-saving possibilities and aid in preventing snap judgments or shortsighted decisions.

It is a well-planned and well-written book covering a wide range of tax-saving possibilities.

FRANK A. DUNN

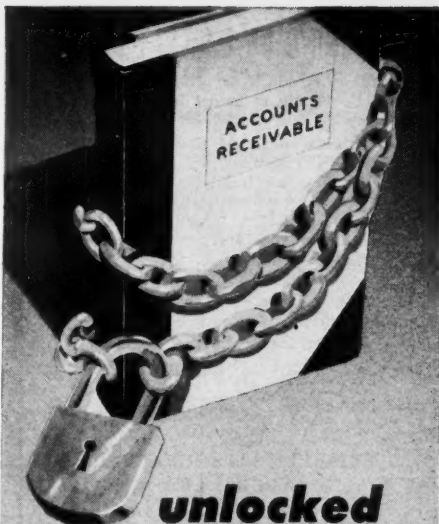
New York, N. Y.

Monatt's Tax Atlas

By Samuel M. Monatt. MATTHEW BENDER & Co., Inc., Albany 1, N. Y., 1953. Pages: 800; \$17.50.

Mr. Monatt's Atlas consists of two parts. The first comprises (a) tax topics arranged in seventy-five chapters of varying size, (b) tax rates and tables, (c) check lists of different income and expense items, and (d) a federal tax calendar. The second part consists of sundry specimen federal tax returns

(Continued on page 360)



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Book Reviews

(Continued from page 359)

and the appropriate instructions published in connection with each. A rather complete index is also furnished.

The Atlas has been published in loose-leaf form. It is the author's purpose to keep Part I up to date by replacement pages for major changes which occur, and by cumulative supplements to cover minor changes. Part II is to be replaced annually as new tax forms and instructions are made available and released.

The topics are presented in outline form and are illustrated by appropriate examples. The language is simple and easy of comprehension. The author's aim is to integrate by examples the techniques of reporting income, deducting expenses, and preparing tax returns in proper tax and accounting procedures, all based upon the tax law, existing regulations, and court decisions.

The Atlas which the author has prepared should prove to be helpful to the tax man in need of ready information and examples to clarify the problems confronting him in his practice.

STANLEY B. TUNICK

Baruch School of Business and
Public Administration
The City College of New York

Accounting Teachers' Guide

Edited by Leo Schloss, et al. Sponsored by the American Accounting Association; published by SOUTH-WESTERN PUBLISHING Co., Inc., Cincinnati 2, Ohio, 1953. Pages: xiii + 258; \$2.50.

Accounting Teachers' Guide represents a pioneer endeavor in the field of accounting instruction. The primary objectives of the Guide as stated in the preface are to emphasize the importance and to improve the standards and methods of accounting instruction at the elementary level. Corollary objectives are (1) to promote greater uniformity in accounting instruction, (2) to encourage teachers to attain academic and professional growth, (3) to encourage the development of visual aids, and (4) to present the value of accounting in relation to other fields of endeavor. The book has an editor for each of its eight chapters and approximately sixty contributing authors.

Chapter 1, *Professional Developments*, includes a brief historical exposé of the teaching profession, accounting, and collegiate accounting instruction; an especially noteworthy discussion of ethical standards of the teaching profession; and a consideration of such topics as the future of accounting teachers, accounting in education, and career opportunities in accounting.

(Continued on page 361)

Book Reviews

(Continued from page 360)

Chapter 2, *Course Content and Conduct*, considers effectively the objectives, content, and teaching emphasis of the elementary course in accounting, stages of accounting instruction, and methods of instruction (lecture, discussion, and laboratory).

A Well-Informed and Better Guided Student is the title of Chapter 3. This chapter discusses student benefits and expectations, student guidance, assignments, examinations, and grading procedures. Particularly appropriate are the statements to the effect that (1) an instructor should not inject his own favorite ideas into a course to the exclusion of accepted theories and practices, (2) elementary accounting is not a professional course, and (3) students should be informed at the beginning of the term as to the composition of their final grade. Of some concern to the reviewer is the statement that an instructor should examine, comment on, and correct all homework assignments. This recommendation seems not only unnecessarily rigid but generally impractical and if followed would tend to prevent the attainment of other desirable objectives.

Chapter 4, *A More Effective Teacher* presents a clear and concise discussion of the eight essential qualities of an effective teacher; namely, knowledge of subject, ability to explain, ability to select and prepare course material, interest, ability to evaluate students, personal characteristics, professional attainments, and research and writing ability.

Non-projected visual aids, projected audio-visual aids, and other teaching aids, are included in Chapter 5, *Teaching Aids*. The emphasis in this chapter is placed almost entirely on the corollary text objective of developing visual aids with the result that inadequate attention is given to the primary objectives of the *Guide*. Especially disappointing in this connection is the lengthy and technical discussion on projected audio-visual aids.

Chapter 6, *Testing*, considers the form of an accounting test (essay, problem, and objective), time allowances, grading, and procuring.

Chapter 7, *The Teacher's Self-Audit*, and Chapter 8, *The Student Evaluates the Teacher*, offer various methods for appraising the individual instructor. Excellent check lists on which to base these evaluations are included in each chapter.

The editors and contributing authors have succeeded in incorporating the mature thoughts and teaching suggestions of experienced accounting teachers into a comparatively brief, well-written, and well-organized book. Every accounting teacher

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regardless of rank, age, or experience will find something of value in this book. Accounting Teachers' Guide deserves more than a single reading; it should serve as an ever present standard by which each teacher may continually evaluate his efforts and may find many helpful suggestions for future improvement. The American Accounting Association is to be commended for its initiative and sponsorship in this unique literary accomplishment.

WALTER G. KELL

College of Business Administration
Syracuse University, N. Y.

Accountants' Index (Tenth Supplement)

Prepared under the supervision of Miriam W. Donnelly, Librarian. AMERICAN INSTITUTE OF ACCOUNTANTS, New York, N. Y., 1953. Pages: 499; \$10.00.

The Accountants' Index, initially published in 1920, and supplemented periodically thereafter, is the standard reference work of the accounting profession. This current (tenth) supplement contains a complete bibliography of accounting literature for the years 1951 and 1952. Authors' names, subjects, and titles are all arranged in a single alphabetical index. The Institute deserves the gratitude of the profession for maintaining so valuable a research tool as this index.

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EMANUEL SAXE, *Managing Editor*

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VOL. XXIV

June • 1954

No. 6

The Opportunities for Public Accountants

By DON G. MITCHELL

In this address, one of our leading industrialists points up the broadened role of the public accountant today. He stresses the importance to management of his interpretive function, and specifies some fruitful areas for its application. He indicates the broad challenges to the accounting profession of the future which are inherent in business' present trend towards automation, decentralization, and the growth of distribution and service business.

MY role here tonight is to look at you from the standpoint of a non-professional who utilizes your services, and to tell you what we in management think you should be doing for us, as clients. I certainly am not going to pretend to second-guess you and your objectives, but rather to make a few comments which I hope will show you how valuable we in management feel your contribution is toward the overall success of our operations.

DON G. MITCHELL is Chairman of the Board of Sylvania Electric Products Inc.

This address was delivered by Mr. Mitchell at the annual meeting of our Society, held on May 10, 1954, at the Hotel Roosevelt in New York City.

The concept of the role of the outside accountant varies a great deal throughout industry, and I am confident that comes as no great surprise to anyone here. The degree of acceptance which the public accountant receives in any company may well be beyond the accountant's control, because of any number of factors, including traditions, personalities, and so on. However, the most significant influence is not exercised by factors outside your control, it seems to me, but rather by factors within your control.

Proper Communication Basic to Successful Professional Relationship

Before becoming at all specific, however, let's discuss for a moment the basic philosophy of the relation-

ship between a business organization and an outside professional service. I have seen splendid relationships, which were contributing immensely to the success of the client's business, and I have seen others which were remarkably close to being useless. In either case, the crux of the matter is wrapped up in that one word "communication". In the successful relationship the two parties were communicating ideas, viewpoints, philosophies, and were trying to make the relationship function as a team; in the unsuccessful relationship, there was little or no communication, and no one was on anybody else's wave length.

To be a little more specific, the lack of communication was evidenced by treating the outside accountants as interim visitors, with the fervent hope that they wouldn't stay too long. It has always been my contention that relations with professional counsel must be harmonious working relationships, or they are worse than non-existent. They will, in fact, actually be detrimental.

The Broadened Role of the Accountant Today

That brings us to the exploration of the extremely basic question which is the very foundation of my remarks tonight, and that question is this: What do we businessmen expect and what do we want from public accountants so that the relationship can be as it should be. Well, easily at the top of the list is: We in management certainly want more than scorekeeping. We want more than simply facts and figures. We sincerely want the objective advice which helps us to interpret and to use that information . . . the sort of advice which can come only from an outsider who is viewing us and our operations with an unprejudiced eye, free of the day-by-day operations of the business.

To get back to my comment that a public accountant should be more

than a scorekeeper, please do not feel that I am waving any accusing finger at you. I am certain that all of you are just as aware of the problem as I, or you would not be here, and it is my purpose here tonight simply to reassure you that we in management recognize your broader role and want to do everything we possibly can to help you perform it properly.

For lack of a better description, what I am really discussing, then, is the "intellectual scope" of your job, rather than the routine aspects. It is a case of knowing the client's business from top to bottom, and being able to relate it to business in general. It is a case of knowing not only that the X Company makes a certain kind of product but what other companies make that product, what the competitive conditions of the industry are, and so on.

Let's look at it from another direction. If your client sells just one product, for example, you can provide a real service by going beyond that one product and studying whether the client's activities indicate that he is running an efficient enough operation to warrant expanding to certain other related lines. There is nothing new in this approach—this business of going beyond the obvious requirements of a job and taking the initiative by broadening your viewpoint and offering the kind of advice which could conceivably increase your client's business and bring him greater earnings. I would say that extending oneself beyond the immediate and basic requirements is an ingredient of success whether you are talking about a public accountant, or a management man, or a salesman, or an engineer, or anyone else.

Importance of the Interpretive Function of Accounting

Before I go any further, I should point out that I realize that the greater proportion of you—nearly 75%, I understand—are individual practition-

The Opportunities for Public Accountants

ers or partnerships, rather than the larger accounting firms. However, whether you are a one-man show, and your clients are small businesses or proprietorships, or whether you are part of one of the major firms, whose clients are large industry, there is one basic similarity: You are performing the fullest service when you make a point of knowing your client's business and knowing it extremely well, when you relate his business to the entire area of business in which he operates, and when you seek to help him become increasingly successful.

Just how do you go about it? The answer to this question revolves around the gathering of sufficient information upon which to study a situation and take appropriate action. This is no new situation, because it confronts businessmen every minute of every day, whether they realize it or not. The accountant, therefore, who not only provides certain facts but reports to his client the significance of those facts so that action can be taken is the accountant who is truly meeting his client's needs.

Some of you who are tax specialists or perhaps procedures specialists know precisely what I mean. Yours is a particularly fruitful field. You are not too different from the engineering firm which studies a given manufacturing process and suggests ways of improving it, of lowering costs, or of increasing output. Nor are you too different from the marketing counsel who advises his client to change his distribution system in a certain way, or to exploit his products with a certain kind of promotional plan in a specific area, or directed at a certain consumer group.

There are, of course, the clients who do not want any advice. They feel fully competent to handle any given situation, and want you to audit the books and then pick up your brief cases and go home. If you were to offer any advice, you would be met with stony silence which in effect says:

If you want to keep this account, stick to your knitting.

It is my distinct impression, however, that those rugged individualists are a vanishing race . . . and are giving way to a type of organizational philosophy which concentrates on teams of generalists and specialists, working together to assure the continued success of the enterprise. There is very little of the "flying by the seat of the pants" in large industry any more. Industry cannot afford it. Action is taken on the basis of scientific accumulation and evaluation of facts. True, the small business has a different situation, but therein lies the challenge to the public accountant. This is a fertile field—showing the smaller business that it, too, can adopt in some degree the techniques of the large corporations.

I agree that certain accounting practices and related functions in larger companies can never be translated to smaller enterprises. By their very nature, many of the corporate accounting practices are tailored to large operations. But the viewpoint is the thing. The viewpoint or philosophy which gave rise to those practices can be used in large or small or any business, equally well. It is simply the recognition of the fact that accounting procedures are more than a routine compilation of information gathered at periodic intervals because of some statutory requirement, but rather that accounting information, properly gathered and effectively utilized, can be major factors in day-by-day success, no matter how large or small the operation.

Improvement in Reporting Techniques Needed

This is not easily accomplished, however, whether you are thinking of a large company with an accounting and statistical organization of several hundred persons, or the small business whose accounting department is

one clerk. It is a question of putting in the hands of top management of a corporation or the owner of a drug-store the information which will help him. I sincerely hope you have not obtained the impression from your colleagues who are controllers or chief accountants that this is all in the day's work, and that this goal is easily reached. There are far too many top executives who are literally deluged with lovely reports, beautifully tabbed and indexed, which contribute virtually nothing. They are really the end products of a fact-finding machine which cannot be stopped, and which goes on and on grinding out information, and distributing it whether it is useful or not.

We are attacking this problem with great vigor at Sylvania, to put it mildly. Our President, our Controller, and I have been waging a very spirited campaign, the past few months especially, to restrict accounting and statistical reports to the absolute minimum, which are sent only to those persons requiring them in their work. This, of course, hurts the feelings of the man who likes to get lengthy reports because they seem to add a certain impressive quality to the top of his desk. But we say at Sylvania: You can have all the information you need, but no more. I like to call it the "rifle shot method of report distribution", in contrast to the "saturation method", which only adds greatly to the work load of the mimeograph section and to the fatigue of the mailing room boys.

This selective process is extremely important and at its best gives an executive a head start in resolving the problems currently plaguing him. An acquaintance of mine hit the nail right on the head the other day. He said his company is finally doing something to stem the flood of reports which relentlessly pursue his executives. "We receive so many reports that we haven't time to do anything about that small bit of really helpful information we find tucked away in some of them.

Hereafter a report must be a useful and a concise one, and it will be sent only to those requiring it."

Furthermore, we are seeing to it that the reports are prepared in such a way that the person getting them can understand them. I am sure you will agree that many professionals, whether you are speaking of accountants or engineers or doctors, tend to use professional terms which leave the average layman completely out in left field. Every bit of a report, whether it is the factual information or the conclusions drawn from that information should be reduced to the smallest common denominator.

I cannot emphasize too strongly the importance of speed. In the fast-moving situations which characterize commerce and industry today, information must be timely or it is useless. Whereas I recognize that a final report must be accurate down to the last penny, the client should be given preliminary or rough figures as soon as they are available so that he can spot the trends. "The sooner the better" are some good words to have in mind.

Our Controller and I have a favorite indoor sport. It consists of a running bet as to which one of us will come up with the best projections. It may surprise you to hear that we usually come up with just about the same answers. In some companies the Controller would lose every time. Do you know why? He would be so intent on reporting facts about the past, that he would ignore the future.

The fundamental responsibility of the Controller is to provide top management with the best possible projections, based upon carefully selected facts. This is another variation of the "outside viewpoint", since he is actually backing off from the routine aspects of his job and is doing a job of interpretation and analysis.

The public accountant is in the same position. He can either become so engrossed in gathering the information that he remains purely and simply a

scorekeeper, or he can first tally the score and then tell his client what it means, and what it seems to indicate for the future.

In performing this advisory service, so to speak, the controller or the public accountant have a common problem: Maintaining their objectivity. All of us will concede that it is extremely difficult to analyze certain types of information with complete objectivity, especially when you have gathered the data yourself or closely supervised the gathering of it. Obviously, certain classes of accounting information cannot be misconstrued by their very nature, even if you tried. But when the entire mass of information is gathered and the process of interpretation begins, you have actually put on another hat, and have transformed yourself from a fact-finder into an analyst. The mental processes of fact finding and analysis are surely different, but the latter must always have the objectivity of the former.

Some Fruitful Areas for Interpretive Activity by Accountants

Perhaps at this stage in my remarks I should produce some sort of check list to augment the various principles which I have been enunciating. Some one of you are probably saying to yourselves: All right, I buy the idea that we should be more than scorekeepers, but what are the most fruitful areas for us? That is a legitimate question, and the least I can do is to supply at least a partial answer.

The opportunities vary to some degree, of course, depending upon the sort of client you serve, because some of the problems of a small industrial company obviously have no counterpart whatsoever in an automobile dealership, or a hardware store, or a construction firm. Some opportunities, however, seem to stretch across the board, and influence all sorts of businesses, large or small.

Inventories are a case in point. Does your client have too much or too little?

Are his cost figures accurate, or is his system so antiquated that his picture is completely distorted?

And how about his *finances*? Are his obligations the wrong kind in the wrong place? What volume does it take under today's set of circumstances to break even and what effect will increased volume have on profits? Or you can ask that last question in another way: "Can the client afford to go out and get more business?" That, of course, involves the principle of marginal balance, and the problem confronting your client is to determine whether he will get his money back, and more. He might find that by doubling his sales expense he not only will more than offset the added expense with increased sales, but will show a handsome increase in net profit. But he may also find that increasing his sales expense will bring absolutely nothing. The only way he will get the answer is by working closely with the man who can help him most — the accountant.

If he is a manufacturer, his *materials handling* may be a particularly fruitful field, or perhaps his *production control records*. Concerning the latter, incidentally, there are many instances where production control records are such that the word "control" is 100 per cent meaningless. Production control all too frequently means adding up how many of what item had been produced, and no attempt whatsoever is made to evaluate whether the production rate was too high or too low.

And how about "*standard costs*"? There is something about the very title "standard costs" which suggests that some act of Congress has established costs which are the yardstick under every conceivable situation and must be adhered to forever after . . . or else. One of the greatest services a public accountant can perform is to conduct a constant educational campaign which points out that so-called "standards" simply mean the cost of producing a given item under certain

circumstances which are then current. Whenever the circumstances change (volume, labor rates, material costs, plant layout and so on), the standards change. I was making that very point to one of our people the other day, and told him that deviations from standard costs made interesting reading but in the final analysis were simply the patient's temperature yesterday. I am much more interested in what the patient is doing today and what the prognosis is for the future.

As our Controller is constantly pointing out, standards should be used to project those future costs which would be allowable and to point up excess costs which are likely to occur, so that something can be done to correct the situation before it gets out of hand. It goes without saying, in other words, that a bad result cannot be corrected after the fact.

I could spend the entire evening on the subject of *taxes*. If there ever were a lucrative field for the public accountant, it is this one. With today's complex distribution systems, and excise taxes, and sales taxes, and all the other taxes, the public accountant who can dig under the surface and come up with well-founded advice on tax problems is the sort of public accountant the client would like to have sitting in his office every day of the year.

Impact of Current Industrial Trends Upon Accounting Opportunities

So far we have been discussing certain broad principles and related them to some specific areas, but all of those comments have been historical in nature, in the sense that they are based to a great extent upon the conduct of business as we see it today. There are, however, certain very definite trends throughout industry which would seem to bear watching by you gentlemen, since they point to some extremely significant changes in the way business operates.

Three of these trends seem to be especially significant. First, automa-

tion; second, decentralization, and third, the growth of distribution and service businesses. Whether you are a member of a large accounting firm or are a one-man operation specializing in one field, the three trends have something in store for you.

Automation

Take, first, automation. The heart of automation is the machine, and the brain of automation is the electronic device or some complex electric equipment. The entire plant may be automatic or major parts of it, depending upon the situation. In a typical automatic plant, the production lines are directed by a central brain which is an intricate system of controls, relays, switches, and other devices doing a multitude of things simultaneously and in sequence.

A few days ago, I had occasion to visit two new plants—one of ours and one of a supplier's. Both of these plants represent the latest word in automatic production in their respective fields, one making photoflash lamps and the other glass bulbs. The striking thing about both plants is their enormous productive capacity. But who determines what the production rate should be, and how about standard costs, shrinkage, quality control, the number of shifts, and so on? The machines certainly don't have these answers, because of one very basic fact: machines cannot think. Machines must be shown what to do. That is the job for a team, representing not only manufacturing, engineering, and marketing, but accounting as well. The necessity for teamwork and coordination is all the more evident in automation, since the consequences of machines acting on inaccurate or incomplete information can be serious or even disastrous.

Automation, which in many ways is still in its infancy, will provide enormous new opportunities for the accountant, especially in such areas of production control, costing, systems and procedures, and so on. When the

automatic plant becomes commonplace, all previous production standards, all previous levels of contribution to the world's standard of living will be completely overshadowed.

Decentralization

Turning now to "decentralization", Sylvania and a large number of companies have found that placing the authority and responsibility for operations as far down the line as possible is the way to run the business. In other words, the local plant manager is the boss and operates under broad controls established by the staff at company headquarters. The benefits are many, and include: Far greater flexibility in operations, faster action, new and better ideas, and greater efficiencies all along the line. This obviously creates quite a problem in communication—so that the decentralized plants will not be operating in separate vacuums, like electrons which have lost the binding force which directs them toward the nucleus of an atom. Though they are decentralized in authority and responsibility, and are given a job to do and permitted to do it, they nevertheless are part of a whole. You can carry "state's rights" too far in industry. To assure coordination—and I do not mean interference with a local manager's prerogatives — company-wide information must be gathered speedily and delivered to those in managerial and policy-making positions in time to do something about it. The accountants have a name for this: Integrated Data Processing, which is a fancy way to describe the process of recording and processing day-by-day information, and presenting it rapidly in summarized form so that management can act while the situation is still fresh.

Here again is a major opportunity for the accountant—helping to develop this system of high-speed communication, deciding what information is required, and what should be done to that information to obtain coordinated

reports. Some of you who have had experience with decentralized companies may wonder if such a system would act to the detriment of the operating man, and tend to centralize controls. It not only would not destroy decentralization but would foster it, by supplying the operating organization with the information they require, and the top management with the information which they need to review operating efficiencies and to provide advice and counsel.

Rapid Growth of Distribution and Service Business

The third trend is the rapid growth of the distribution and service business—the millions of small businesses which distribute, sell, and service the mass production items which characterize our standard of living—the items produced by our increasingly automatic factories and decentralized companies. As industry becomes increasingly automatic, there will be concurrently a strong upward trend in the distribution and service businesses. I am sure that you, as well as I, are aware of many instances where this area of our economy has not kept pace with consumer needs. Getting any mass-produced product out the back door of the plant is only part of the picture. Selling it, installing it, and servicing it is a huge industry in itself, and will expand at an unprecedented rate in the future.

In this distribution and service area lies a third opportunity for the accountant, especially those of you whose clients are the small enterprises. The vast majority of these businesses may be relatively small in size, but what they lack in business volume is compensated for a million times by their number, which is increasing steadily throughout the country.

This area of the economy, i.e., distribution, has a constantly recurring characteristic which further emphasizes the need for the kind of service which only an accountant can provide.

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The Independent Auditor's Role in Charitable Organizations

By MAX WASSER, C.P.A.

This paper outlines audit steps and techniques for a charitable organization and discusses the importance of the auditor's report in light of recent legislation.

THE independent public accountant who audits the books of a charitable organization undertakes a number of responsibilities: to the Board of Trustees who engaged him, to the creditors who will rely on his statements, to various agencies and possibly governmental bodies to whom his reports must be submitted, and most important of all to the public at large whose contributions go towards the support of such organization. It is obvious then, that to discharge his duties properly, the auditor must not only be familiar with fund accounting, but should also be equipped to handle the accounting problems unique to such institutions. Too often, accountants well versed in the accounting procedures applicable to commercial enterprises feel that such procedures are equally applicable in the audit of a non-profit organization. The result is an inadequate audit, as well as a report that fails to portray a proper picture of the financial story of the charitable organization. It is my purpose to point

out some of the areas wherein the audit of a charitable organization differs from that of a business enterprise, and to indicate the nature and importance of the auditor's report.

I—Audit of Income

By virtue of the very basic differences in the sources of income of a charitable organization and a business organized for profit, the audits in this respect are necessarily different. As the income of a business is generally geared to sales, such techniques as gross profit ratios, inventory turnovers, etc., are available to the auditor seeking to verify the accuracy of the income reported. On the other hand, the income of a charitable organization is geared to the response of the public to the appeal presented by such institution. This necessitates a close scrutiny by the auditor of the system of internal control employed by the organization. He must be ever conscious of any weaknesses in such control and is expected to make recommendations for improvements. For example, the auditor should insist that all monies be deposited daily and that an official prenumbered receipt be prepared in duplicate for every item of income received. Where payments are made at the institution, a copy of such official receipt should be prominently displayed with an appropriate notation to the effect that such a receipt should be requested for all monies paid.

Having reviewed the system of internal control, the auditor is now ready to proceed with his examination

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This paper was presented at a technical meeting of the Society held on March 31, 1954, under the auspices of the Society's Committee on Institutional Accounting.

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of the various items of income. First will be the unrestricted pledges and payments made by the public as contributions. The following are some of the audit steps to be used:

1. Comparison of the amounts shown in the books of original entry with duplicate receipts and underlying letters and documents from the contributors. In examining such correspondence, the auditor must be careful to look for possible restrictions as to use, placed by the donor on his gift.
2. Examination of the minutes of the Board of Trustees, where gifts especially of the more sizable sums are mentioned.
3. Where pledges are recorded as income, it would be desirable to verify the accuracy of such pledges by independent confirmation with the contributors. While this is considered good auditing procedure, it will be found that more often than not, the Board of Trustees will be hesitant in granting permission to the auditors.

As an alternate step for the verification of such pledges, the auditor should request permission occasionally to send out the bills for unpaid pledges. The returns should be controlled by the auditor, in such manner as to detect any complaints for discrepancies.

Legacies and Bequests

There is often an extended gap of time between the death of a testator, the probate of his will, and the payment of a legacy or bequest to the beneficiary. This is especially so, when the payment of the legacy in the form of a remainder is postponed until the death of a prior life tenant under the will. Therefore, it is important for every charitable organization to maintain a complete register of pending legacies and bequests. Upon notification that the organization has been

named as a legatee under a will, a copy of such will should immediately be requested. At the same time an appropriate notation should be made in the register. On receipt of the will, it should be turned over to the attorney for the organization for his determination of the amount to be received, and as to any restrictions and interpretations of the terms of the legacy. This latter step is most important, as such conditions of a testator are binding and must be carefully observed. Many organizations make it a practice to have their attorneys keep all the files on pending legacies and bequests. If this be the case, the attorney should keep the organization currently informed as to the status of each legacy in order that proper entries can be made in the register.

What should the auditor do to satisfy himself as to the accuracy of the legacies and bequests recorded on the books of account?

1. He should compare the register with entries made in the books of account.
2. He should ascertain that any restrictions indicated by the attorney are being observed.
3. Where sizable legacies are involved, the accountant should himself examine the papers in support of such legacies to determine if the amounts recorded on the books of account are accurate and whether restrictions, if any, are being followed.

Other Sources of Income

Where the charitable organization charges a fee for services rendered, the best possible source of verification are related statistics of the number of treatments, the number of students registered, etc.

Where grants are received from governmental bodies and related organizations, independent communication by the auditor is a suggested means of verification.

Interest and dividends received on investments should be audited in much the same manner as would be the case if the investments were owned by a commercial enterprise.

Before I proceed with the discussion of the audit of expenditures, I would like to point out a step in the audit of income that should not be overlooked. That step involves the comparison of the copies of receipts issued with duplicate deposit slips obtained by the auditor directly from the bank. This procedure was successfully used to uncover a defalcation in a University. It seems that the cashier, in addition to handling cash payments by students for tuitions and other fees, also prepared the daily bank deposit. This of course, is not desirable from a standpoint of internal control, but is a situation found in many non-profit organizations. The cashier, on receipt of a check from a non-recurrent miscellaneous source, would omit making a record of such receipt. The check would then be used to cover a like amount of cash withdrawn from tuitions. It was not until the auditor compared duplicate deposit slips which separately itemize checks, with the corresponding days' receipts that he was able to uncover the shortage. It is to be noted that this procedure can only be effective where the receipts issued indicate whether cash or check was received. In addition, the cashier must refrain from cashing checks for the staff, which often is done as an accommodation.

II—Audit of Expenditures

The key words in the audit of expenditures of a commercial enterprise are "reasonable and necessary". Having always in mind the tax consequences of an expense, the auditor of a business should point out where in his opinion an expense is unreasonable or unnecessary and indicate to his client the possible disallowance of such item for tax purposes. In a charitable organization, it is not within the pro-

vince of an auditor to say that the purpose of an expense is not necessary. The key word is whether the expenditure is properly authorized. It is true that with the responsibility the auditor has to the public whose contributions support the charitable organization, he should judiciously point out those expenses which he feels should be avoided. For example, he should not hesitate at least tactfully to raise the question as to the propriety of an apparently exorbitant amount on a travel expense account statement.

Although in the main the various items of expense such as payrolls, purchases of supplies, etc., are subject to the same auditing procedures as are employed in the audit of a commercial enterprise, the following are some additional audit practices that may prove helpful in determining the accuracy of the expenditures recorded on the books of account:

1. *Payrolls:* Where a sizable staff is employed, it is highly desirable to engage in periodic surprise pay-offs. That is, with the knowledge of only a key person in the organization, the auditor should arrange personally to witness the distribution of payroll checks. In that way he can detect padding, and also serve to let the entire staff know that the accounts of such organization are being audited. As an alternate procedure, the W-2's given to employees at the end of the year can be employed for a dual purpose. Instead of having the organization itself distribute them, the auditor should mail the W-2's in his own envelopes, together with a request that the employee notify him directly of any discrepancies. Only recently, via this device, a dishonest practice was uncovered at a hospital. A nurse who had left the hospital's employ during the year, complained to the auditor that the amount of salary reported on her W-2 was in excess of the amount earned by her. On investigation, it was found that her supervisor had never reported to the accounting de-

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partment that this nurse was no longer with the hospital. The payroll checks for such nurse were thereafter cashed by such supervisor. The obvious weakness in the internal control which would have prevented this embezzlement was thereafter corrected.

2. *Reimbursements to employees for outlays:* Whenever an employee of an organization has the right to authorize an expenditure, such right should never be extended to permit authority to disburse monies to oneself. A counter-signature of a superior should be required. Where the executive director is involved, the counter-signature of a Board member should be insisted upon. As an alternate, key employees should be placed on fixed expense allowances.

3. *Comparison of budget with actual expenditures:* As a guide to the determination of the accuracy of expenditures recorded, the auditor should make use of the budget approved by the Board of Trustees. Where actual expenditures vary significantly from amounts in budgets, the auditor should inquire for the reasons for such variations.

4. As an additional element of the internal control of expenditures, the auditor should insist that at least one of the unpaid officials of the organization, countersign all checks.

III—The Auditor's Report

Only recently the New York State Legislature amended the Social Welfare Law for the purpose of more closely regulating the operations of charitable organizations. (See Chapter 418 of the Laws of 1954.) It was the result of recent investigations into the activities of some unscrupulous charities that such legislation was enacted. The following section thereof is pertinent:

"§ 482-b. Reports by registered charitable organizations. Every charitable organization required to register pursuant to section four hundred eighty-two of this article which has received contributions

during the preceding calendar year shall file a written report with the department upon forms prescribed by it, on or before March thirty-first of each year, which shall include a financial statement covering the preceding fiscal year of operations, verified by an independent public accountant clearly setting forth the gross income, expenses, and net amount inuring to the benefit of the charitable organization. A charitable organization which maintains its books on other than a calendar year basis shall upon application to the department therefor be permitted to file its report within ninety days after the close of its fiscal year. Such report shall state the names of its professional fund raisers and professional solicitors used during the year, if any, and the amounts of compensation received by them. Such report shall become public record in the office of the department."

In light of this legislation, the auditor's report obviously takes on added significance today.

I now want to point out some guides in the preparation of an auditor's report. To begin with, the report of a charitable organization should be drafted along the lines of fund accounting. As a non-profit organization is akin to a custodian or a steward holding various funds for different purposes, the report must be prepared in such a manner as to show separately both the status of the various funds as at the end of the year, as well as the operations of each fund for the year then ended.

Various problems arise in the preparation of the report by virtue of accounting practices peculiar to charitable organizations. For example, the accrual basis is the generally recommended practice as to expenditures. On the other hand, few institutions accrue interest income. In addition, many prefer not to record pledges as income but rather treat such items on the cash basis. Depreciation of fixed assets is also often disregarded. Whichever basis is used, the auditor should insist that the Board of Trustees adopt the specific method of accounting to be used. This will serve to minimize the possibilities of juggling of accounts,

when inconsistent bases are used from year to year.

The question arises as to the necessity of qualifying an auditor's certificate where deviations from accounting principles for commercial enterprises appear in non-profit organizations. A special committee on college and university accounting, appointed by the American Institute of Accountants to cooperate with the National Committee on the Preparation of a Manual on College and University Business Administration has answered this question with respect to accounting for colleges and universities. Their conclusion was that if the educational institution maintains its accounts in conformity with generally accepted accounting principles for colleges and universities, the certificate need not be qualified. The question remains unanswered as to other charitable organizations for which a separate compilation of generally accepted accounting principles has not been prepared. It is

my belief that where the departures from generally accepted accounting principles for commercial enterprises have a reasonable basis, and are widely practiced by other similar non-profit organizations, no special qualification of the auditor's opinion is required. However, in the notes accompanying the financial statements, full and adequate disclosure should be made of the official policies and practices in use.

As individuals are prone to accept the name of an auditor as assurance that the funds of the organization are being properly administered, it is important that the auditor's report be clear and readily understood. Moreover, an auditor's report that fails to present a truthful picture of the finances of an organization not only is useless, but is dangerous and misleading. The law just enacted in Albany is a good thing, but it is up to the auditor to do his best and to offer all possible assistance to make sure that the law will actually serve the purpose for which it was intended.



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This characteristic is the tendency to act on incomplete information, to fly by the seat of the pants, to operate on a day-by-day basis. I certainly recognize that the consumer market is a dynamic thing, and is subject to swings and fluctuations which make life utterly miserable for the small businessman. However, much of this misery comes from lack of adequate information and outside advice which a public accountant can give his client.

Well, gentlemen, now is the time for me to close up this auditing report and summarize my findings. I am firmly convinced that the public accountant can be one of the most productive elements of any business. However, yours

and my realization of that fact is only half of the picture. Convincing your clients is the other.

You have a high-quality product to sell, and it is high quality for a very basic reason: It is capable of helping your client sell *his* product. The challenge for each one of you is broad, and it is expanding steadily. This economy of ours may require a tuning-up job every so often, such as the adjustment which now seems to be virtually completed. But the long-run picture is just about as broad as the universe.

To the man who will say: Let's forget what happened yesterday, or even today, and look at the future, there are unlimited opportunities.

Practical Aspects of Accounting and Auditing in Hospitals

By FREDERICK GRUBEL, C.P.A.

Hospitals are not basically different from other clients of a public accountant but they have to be considered as a very particular industry. Even when auditing and analyzing such common-place accounting items as accounts receivable, plant and equipment, inventory, and costs, there are problems arising from the specific structure and organization of hospitals which require a specialized approach and technique in order to give the hospital administration real and full benefit of the auditor's service and thus further the institution's business efficiency. These are discussed herein.

Hospital as Non-profit Institution

It is often claimed by hospital administrators that the existence or the lack of the profit motive is of decisive importance when judging the business structure of their institutions. I do not agree with this opinion. The business practices and procedures should not be influenced by the fact that the voluntary hospital does not aim at profits, while the proprietary hospital is operated to yield a profit for its owners. Of course, I am considering only hospitals that are ethically run.

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A proprietary hospital can very well have an ethically proper administration and nevertheless yield a reasonable surplus. If we restrict our consideration to well-operated hospitals, the sole difference in the business aspect between voluntary and proprietary institutions is the direction of the financial planning. The voluntary hospitals aim at an income short of expense within a reasonable margin of a planned deficit that may be called "the philanthropic gap", while the proprietary hospital operates in order to have a reasonably well-foreseen profit. The basis of the difference between the two approaches is the fact that the voluntary hospital is created in order not only to serve those who can pay their own way, but also simultaneously to take care of the sick poor or, in social service language, of the medically indigent. The proprietary hospital, as a private business enterprise, can as little afford to give something for nothing as any other honest businessman and, therefore, as a rule does not provide for the care of medically indigent patients.

If this is understood, it follows automatically that the voluntary hospital has as little excuse for neglect of sound business practice as any profit-making or, better, profit-aiming organization. Whenever a public accountant is called in as consultant or

auditor of a voluntary hospital, he should insist on sound business practices to an extent greater than he would do in a similar capacity with regard to a strictly business enterprise. Waste in expense and unwarranted loss of revenue must not necessarily reflect on the service rendered by a profit-aiming organization because the impact may be absorbed by a reduction in profit or capital. The same bad procedures and practices prevailing in a voluntary hospital might reflect much more intensely on the quality of the professional service rendered, because an unexpectedly high deficit might be much more difficult to cover than a reduced profit. The capital structure of many charitable institutions is weak and the philanthropic gap has to be covered mostly by private contributions. It is not at all an easy task to attempt a supplementary fund-raising campaign if it turns out that the goal set for the original campaign was not high enough to cover the actual deficit. Finally, there is the moral obligation of the trustees and administration of voluntary hospitals to put to the best possible use charitable contributions which have the character of trust money. It is the hospital proprietor's own affair whether he loses his own money through inefficient business operation of his hospital, as long as the patients are professionally well cared for. However, it is bordering on breach of trust if a voluntary hospital that relies on philanthropic contributions squanders its means through lack of business-like efficiency.

Conclusion for the practitioner: Do not accept philanthropy as an excuse or explanation for lack of business efficiency in a voluntary hospital.

Hospital Balance Sheets

The outstanding feature of the balance sheet of most voluntary hospitals is the presentation of a whole variety of funds. As in other educational or charitable institutions, the voluntary

hospitals usually have at least some special and endowment funds in addition to their general fund. There is quite often a more or less active building fund and, finally, you may find in most instances a special section including plant and equipment. In the past there has been quite some discussion of the problems of fund accounting and the merits and faults of sectionalized balance sheets and the very frequent complication of inter-fund indebtedness. Since these problems are not unique to hospital corporations, I will not discuss them here.

I would much rather concentrate on three balance sheet items which do not look at all unusual and which are certainly not restricted to hospitals, but which nevertheless represent a special problem for audit approach when encountered by hospital auditors. These items are accounts receivable, plant and equipment, and inventories.

Accounts Receivable

I do not intend to dwell upon the routine of confirmation of accounts receivable and of the well-developed auditing procedure covering the relationship between a concern and its normal business debtors. However, in hospitals the structure of the receivables is basically different from normal trade receivables. In most institutions the patients' bills are composed of charges for a variety of services, in addition to the charge for room and board. However, some institutions introduced all-inclusive rates which are multiplied by the number of days and do not vary according to treatment, medications, etc. The only variation in these instances is based on the accommodation (private, semi-private and ward).

Moreover, there is another peculiarity. Regardless of the hospital's charge systems, a large percentage of the patient income—usually nearly or more than 50%—is derived from Blue Cross plans and from municipalities. The relationship with these organiza-

tions is different from that with commercial insurance companies, since the hospital is contractually bound to treat their beneficiaries at prices set by them and not by the hospital. While Blue Cross tries to meet hospital costs and the City (at least New York City) pays only part of such cost for medically indigent patients, there is in no instance any relationship between the individual rates established by the hospital for its services and the pay tendered by these "third parties." The audit of such "third party" revenue is rather simple. The rates of reimbursement set by Blue Cross and the City have to be ascertained. Written approval slips for each beneficiary should be in the files of the hospital's Accounting Department and confirmation of receivables can be obtained from Blue Cross and the City, respectively, without the necessity of contacting the multitude of patients on whose behalf payment has been made.

A much more complex situation exists with regard to patients who are not covered by Blue Cross or the City and who are hospitalized in institutions which have detailed charges. There, the auditor may be tempted to be satisfied with a check of the charge slips originating in the various hospital departments (operating room, pharmacy, x-ray, etc.) against the individual patient accounts. This alone is a man-sized job. Nevertheless, I do not think that an audit is complete if there is not at least a test-check made of the charge slips themselves. This test-check should cover two aspects. First, the auditor should make sure that the charges actually agree with the hospital's rate schedule. This is complicated by the multiplicity of the special hospital services. A sample listing of hospital charges published by the United Hospital Fund of New York includes 70 different laboratory charges and a variety of more than 50 charges originating in the x-ray diagnostic department. The number of different articles dispensed and charged by the hospital's

pharmacy, runs at least into many hundreds. When we, in addition, take into account that each one of this multitude of charges is designated by scientific terms which do not belong to the every-day accounting language, it may be understandable that I recommend only a test-check and not a complete audit.

However, this aspect of the specialized audit of accounts receivable is by far not the most difficult of the two. The real problem arises when the auditor goes about to check the charge slips against the functional record documenting the rendering of the service billed to the patient. This documentation is contained in the patient's chart. The chart consists of the recording of the entire hospital history of the patient. It is the product of cooperation between the nursing and medical staff, while its personal data originate in the Admitting Office. Whatever hospital service the patient receives, whether it be a surgical operation or a certain amount and kind of medication, whether it be an x-ray examination or a laboratory analysis, is recorded in the chart. It is within the purview of a carefully made audit for the auditor to satisfy himself that the patients are duly charged for whatever service they received, and not for more or for less. This result can only be attained if reasonable tests are made comparing the charge slips against the hospital chart.

In this connection, a serious legal problem arises. Much of the information recorded in the chart is privileged information. It is not supposed to be disclosed to any outsider without the patient's formal consent. It could be argued that the independent auditor is such outsider and that, thus, the hospital is estopped from allowing him to inspect the chart. In this instance, the auditor should satisfy himself that the hospital establishes an internal procedure which guarantees that, at least on a test basis, patients' accounts and patients' charts are checked against

each other by qualified personnel. The record of such internal audit should be presented to the auditor who will be able to draw his conclusions as to the reliability of the hospital's accounting on the basis of the number of discrepancies disclosed by the internal auditor.

I personally tend towards the opinion that the auditor retained by the hospital's Board is to be considered as an agent of the Board of Trustees in whom the personality of the hospital is vested. Under these circumstances, it might be interpreted that the hospital has an inherent right to admit the auditor to an inspection of the chart in the same way in which any hospital employee is allowed to read the chart if this is within the limits of his hospital duties.

Conclusion for the practitioner: In addition to the normal and conventional procedure of auditing accounts receivable, the hospital auditor should make it his business to audit, on a test-check basis, the charge slips from which are built, the accounts receivable from patients not covered by Blue Cross or the City, against the hospital's rate schedule as well as against the patients' charts. The latter audit should be done either directly by the auditor or, if legal objections are raised, through scrutiny of the records of the hospital's own internal staff auditor.

Plant and Equipment

The lack of necessity of accounting for profit and of keeping records for tax purposes, combined with the fact that hospital buildings are usually purchased and constructed with specially collected building fund donations, result in many instances in lack of accurate accounting for the value of plant and equipment. Matters are further complicated by the fact that depreciation accounting is not yet recognized as necessary, or even as reasonable, for philanthropic institutions. On the other hand most hospitals not only have very valuable buildings, grounds and equip-

ment, but also use these assets to provide themselves with borrowed capital. Mortgages are not at all rare on hospital property. It is doubtful whether the accountant will succeed in determining a balance sheet value for plant and equipment which compares reasonably with the evaluation of similar assets in commercial and industrial balance sheets. Where such determination is impossible, the auditor will want to establish very clearly the basis of whatever evaluation of plant assets is on the books. When he feels that the book value either does not correspond with reasonable value or that he cannot form any opinion about such reasonableness, he might have to refer to this fact through an exception made in his audit certificate.

Conclusion for the practitioner: The audit certificate for a voluntary hospital should clearly indicate the basis for evaluation of plant and equipment assets.

Inventories

Hospitals carry so diversified an inventory as only few industries do. In addition to handling the vast variety of medical and surgical supplies and equipment, any fair-size hospital operates a very busy pharmacy and has the task of running a hotel with complete room service. The job of purchasing, storing, converting, distributing and, to some extent, of selling these supplies is formidable. Some supplies are consumed during the operation of the hospital without the possibility of tracing the consumption to individual patients. Other supplies are sold outright to individual patients. This refers essentially to some drugs and pharmaceuticals, as well as to some surgical supplies like catheters and special dressings. Finally, there are many items which finally go to patients after having been combined or converted into new commodities. These examples show that hospital operations involve production as well as sales distribution, in addition to the task of equip-

ping and feeding the service departments. It is quite clear that meticulous records and procedures could be devised which would account for every thread of catgut, every milligram of penicillin, and every pound of potatoes. There is a definite risk that the accounting practitioner may lose himself in developing the most perfect cost accounting and control system, and then find himself out of a job because the cost and red tape involved in such a perfect system would stymie both the hospital's finances and operative efficiency. It should be kept in mind that despite the huge diversity of items, the individual quantities of each commodity are relatively small and a superperfect recording and cost accounting system very easily prices itself out of usefulness. With the exception of very big institutions that include at least 1,000 beds or more and have substantial budgets, hospitals are not the place for the development of all the paraphernalia of high-powered industrial cost accounting. An average medium-sized hospital of a few hundred beds should keep perpetual inventories for the 400 to 500 most important supply items outside the pharmacy, as well as for the more expensive drugs, especially antibiotics, in addition to narcotics and alcohol for which federal law requires current inventory control. For practically all other supply items (and they may very well run into the thousands), I would be satisfied with having proper storekeeping with bin cards attached to the shelves, as well as physical inventories taken approximately twice every year. Of course, the auditor has to ascertain proper documentation of receipt and distribution.

If possible, the hospital staff in cooperation with the auditor's staff should take stock throughout the house on or about the balance sheet date. This physical inventory should include not only supplies kept in store rooms and the pharmacy, but also the supplies distributed for use throughout the in-

stitution (in nurses' stations, operating room, delivery room, laboratories, etc.). In addition, the hospital administration should provide for surprise inventories taken for different items on different days anytime during the business year.

Another difficulty for the auditor is the fact that many stock items in hospitals are completely unknown to him unless he has among his staff people who are well versed in medical and surgical supplies. He should compare the list, at least on a test basis, with illustrated catalogs that may be available through the big medical and surgical supply houses. As a matter of fact, in 1952 the Hartford Hospital of Hartford, Conn., issued a very interesting illustrated catalog of their standard supplies, which is sold at cost by the hospital and which can very well serve as a basic source of information for the inventory of other hospitals.

A completely specialized job is involved in the pharmacy inventory. If the auditor really wants to control the information given by his client, he has no choice but to ask the hospital to have an outside pharmacist of his choice take or supervise the taking of the pharmacy inventory.

Conclusion for the practitioner: Sound judgment and good common sense are the major requirements for the auditor when he decides upon the audit program and upon recommendation of procedures involving hospital inventory. Application of refined industrial standards may be so impractical as to defeat the usefulness of the auditor's work.

Hospital Costs and Budget

Quite often the auditor is called in to advise the hospital administration on the preparation of the hospital's budget. The budget usually is based on cost experience of the past.

One of the most popular cost statistics used within the hospital field is the average cost per patient day. Many New York hospitals develop this cost

by very detailed departmental cost accounting, especially in view of the requirements of the United Hospital Fund. This Fund ties its annual distribution of campaign proceeds to a rather detailed cost report that has to be rendered by all its beneficiaries.

As valuable as such historical reports are, they do not take care of an analysis which is of critical importance for the administration's thorough understanding of the financial implications of the hospital operations. Historical unit costs whether they be calculated over-all per patient day or whether they be broken down departmentally are, of course, influenced by the hospital's census. As long as the census continues on an even level, these historical costs are quite useful. However, as soon as there are significant variations month by month or year by year, the over-all experience figures lose much of their value. Such variations may be conditioned seasonally, but they also may show a trend of shift of population and finally they may be the consequence of rearrangement, expansion, or contraction of hospital facilities. During such periods of variation it is most important for hospital administrations to have a guide for anticipating their financial development. Such a guide can only be computed if an analysis of the fixed and variable components of hospital income and expense is available.

There is no hard and fast rule which can be applied uniformly to all hospitals. The specific situation of the hospital with regard to its physical layout, its admission policy, its arrangement of accommodations, its organization of professional services, etc., determines the actual relationship of these costs. They can only be developed on the basis of an individual study of each hospital's experience. However, there appear a few trends which may be found in practically all cases.

As to income, it can be said more or less that it varies in line with census.

A hospital which has a very high percentage of Blue Cross and City patients, may be less dependent for its income on the severity of the cases treated than a hospital whose patients are not covered by Blue Cross or municipal payments and who, therefore, are billed for every single service rendered by the Hospital. A fixed factor within the income picture might be provided by investment income and, to some extent also, by fund-raising income. The latter is the case when the fund-raising proceeds of one year's campaign are set aside for use in the ensuing fiscal year.

Insofar as expense is concerned the practitioner will have to unlearn somewhat the normal cost approach. It is generally felt in industry and commerce that the payroll is one of the most variable items within the cost picture. As business recedes, workers are laid-off and vice-versa. In hospitals such a rule does not exist. Hospitals are prepared to accept a certain number of patients. This number coincides with the number of beds held in readiness for the sick. As long as such a bed is awaiting its patient, it is necessary for the hospital to have the nursing power available to serve the potential patient, to have the room cleaned and heated, etc. If a hospital has a ward of 15 beds, the same nursing, housekeeping, kitchen and maintenance staff is needed whether all 15 beds are occupied or whether 12 beds are vacant. The break only occurs if the administration decides to close down a full unit or to open a full unit. This consideration is especially important during seasons of low occupancy when income recedes while the decrease in census may not be drastic enough as to warrant closing of floors or wards.

These payroll considerations are similarly true for everything connected with actual maintenance and repair of the hospital's premises. The only expenses which usually appear as variable are food cost and cost of medica-

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Unit Costs for Educational Institutions

By WILLARD R. SCHILLER, C.P.A.

This paper discusses the methods of determining unit costs for educational institutions, based on units of measurement of full-time student equivalent or student credit hour.

IN the March, 1954, *Journal of Accountancy*, Ralph S. Johns' article on Authoritative Accounting Guide for Nonprofit Institutions covers limitedly the recommendations of the National Committee on the Preparation of a Manual on College and University Business Administration, contained in Volume I of College and University Business Administration. No reference was made to Chapter IX on Allocation of Indirect Expenditures and Determinations of Costs. I believe this subject of sufficient importance to submit to you the following comments, observations and methods.

The distribution of indirect expense is essential if true operating costs are to be determined with any degree of accuracy. Such distributions are usually associated with the term "cost accounting", which is defined in part as that branch of accounting dealing with the classification, recording, allocation, summarization and reporting of current and prospective costs. "Unit costs for educational institutions" is the determination of the cost for a full-time student equivalent or student-

credit hour by departments, functions, responsibilities, and activities. Because educational institutions are operated on a nonprofit-making basis, the problem of cost accounting in colleges has not attained the significance accorded it in commercial enterprises. Also, little attention has been given to the methods of allocating overhead expenses. There are times when it is advisable to be able to develop unit costs and perhaps it might be advantageous to determine them regularly as a part of accounting routine.

Financial reports of institutions are taking on a uniformity that they have not shown in the past. I believe there will be an increased use of unit cost data which will lead to improved efficiency of operation.

Institutions that raise and expend money must know the cost of the various programs conducted. This knowledge is essential to the preparation of a budget and in accounting for the expenditure of funds. The operational costs of a program must be known in order to plan adequately, and within its resources for the services it renders.

There are many ways in which a knowledge of the cost of services is valuable to institutions. It will enable them to evaluate their programs in terms of cost, estimate costs of improvements in specific schools, determine cost of establishing new schools, provide the basis for requesting funds from various sources, for accounting for the expenditure of such funds, for determining tuition rates, for establishing controls over the expenditure of funds, and ways of comparing unit costs of specific programs under varying conditions.

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This paper was presented by him at a technical meeting of the Society held on March 31, 1954 under the auspices of the Committee on Institutional Accounting.

A cost system which enables the institution to find the cost of the different elements that make up the program can be used as an administrative control. An administrator can determine which element or elements have altered the cost of any programs and act accordingly. If institutions use the same methods in calculating their costs, comparisons may be possible. They should use caution, however, in drawing conclusions from cost comparisons for, in determining whether a given program is out of line, the quality of the service rendered and results achieved must be considered. Unfortunately there may not be a satisfactory method of measuring either quality or its ultimate results.

Comparisons can be helpful if costs of programs are separated into the various factors entering into over-all costs. If the cost of each of the variables is known, the factor that made an activity in one institution more or less expensive than in another organization may be isolated. Although comparisons may be deceptive, it is often possible to see whether there is a common pattern of cost in similar institutions.

It is extremely important to use the same methods in finding costs if comparisons are to be made. There is more than one correct way to calculate costs, and the use of different methods may result in different unit costs. If comparisons are desired, institutions must conform to and use the same method. The method of computing costs presented in this outline allows for flexibility. It may be adapted to obtain costs of many separate activities or may be used to determine costs of only one activity.

There are times when optional procedures should be considered as a means of meeting circumstances that are common to some institutions and not to others. More effective ways of gathering statistical data or determining costs will be devised in due time.

I propose that the following is an

acceptable plan of allocation. Costs of non-revenue producing departments or functions are allocated to all cost centers which they serve whether or not they are revenue producing. As the costs of each non-revenue producing department or functions are in turn allocated, the costing process for that center is for general purposes considered closed, and no further charges or credits are applied in subsequent allocations. When this method is used, the cost of that department or function rendering service to the greatest number of other departments while receiving benefits from the least number of departments is first allocated.

The classifications submitted herein for allocation are in accord with Volume I of *College and University Business Administration*. More specifically the centers for allocation and means of allocation follow.

Staff benefits include expenditures for group insurance premiums, retirement contract premiums, retiring allowances, and social security taxes, and include only those expenditures which have not already been charged directly to other departments or functions.

Allocation may be based on the distribution of salaries and wages or charged to departments and functions in accordance with the actual coverage by type of benefit whichever is the more appropriate. In the first instance, distribute the total net expenditure only among those departments or functions which have not been charged with this expense, in the same ratio as the distribution of salaries and wages.

General institutional expense includes all current expenditures which serve the institution as a whole, exclusive of general administration, operation and maintenance of physical plant, library, staff benefits and student services, which are separate cost centers. As noted for staff benefits and kept in mind for the remaining cost centers, include only those expenditures which are not charged directly

Unit Costs for Educational Institutions

to other departments or functions. Allocations are made on a dollar-volume basis in the relation of the direct expenditures of each department or function to the current direct expenditures of all departments or functions. Some items included in general institutional expense classified as alumni office, bulletins, commencement, convocations, etc., may have no relation to certain departments or functions such as auxiliary enterprises or organized research. Because items of this character are few in number and their total expenditures are relatively small, it is believed that allocations to all departments or functions on a dollar-volume basis is sufficiently accurate.

General administration includes all current expenditures of the governing board, president's and vice president's office and business office.

Allocations are made on a dollar volume basis in the relation of the direct expenditures of each department or function to the total current direct expenditures of all the remaining departments or functions not allocated to this point.

Operation and Maintenance of Physical Plant

It is common practice to include under the classification of "Educational and General" all expenditures for operation and maintenance of physical plant which have not been charged to non-educational departments or functions. Thus, in certain instances, some expenditures for auxiliary enterprises are included and tend to inflate costs of instruction and departmental research. This possibility should be borne in mind in efforts to determine a fairly accurate or even an approximate cost of physical plant operation in relation to instruction.

The method used for allocating expenditures for operation and maintenance of physical plant will vary depending upon the availability of essential data. The generally accepted

basis for allocating these expenditures is area, or volume of plant space used, adjusted also for the time the plant is in use.

Institutions wishing to determine only the approximate costs relating to plant operation and maintenance may find the following method of distribution sufficiently adequate to meet their needs. Consideration is given to the possibility that within a given institution direct costs may be available for some buildings while for others costs must be determined by an indirect method.

As a first step, the total expenditures for operation and maintenance of physical plant is allocated according to area among all buildings used in connection with any of the following departments or functions which have not been charged directly for operation and maintenance of physical plant: Auxiliary enterprises, library, organized activities, student services, instruction and departmental research, organized research and extension.

Before such allocations can be made, however, certain preliminary steps are necessary. First, establish a base, namely, adjusted square footage of floor space, which can serve as a reasonable basis for allocations.

All buildings used in part or in full for the above purpose should be listed and the gross inside floor space should be recorded for each building, but excluding any floor space the cost of which has been classified as a direct expenditure of a given department or function. A use factor for each building must then be determined and multiplied by the floor space to determine an adjusted floor space factor. A percentage ratio can then be determined for distribution of costs.

The second step, in two parts, requires in the first instance an allocation to be subsequently redistributed and applies to those few buildings which house departments or functions relating to general administration and

general plant operation. It is necessary to isolate these items in order to distribute their costs equitably.

The second part of this step is to schedule allocations limited to departments and functions such as auxiliary enterprises, general library, organized activities, student services, instruction and departmental research, organized research and extension.

It should be noted that in all schedules of square foot area prepared, general purpose space such as hallways, stairways and service areas should be excluded. In the case of classrooms and laboratories used by two or more instructional departments, the space should be charged to the department which has primarily the greatest use of the space.

The allocable costs to be redistributed as noted in the first step above should be prorated to all other departments or functions as noted in step two above, in direct proportion to their total net direct expenditures.

Auxiliary enterprises consist of enterprises operated primarily for service to students and staff and which are usually intended to be self-supporting, that is, the income from sales and services should pay for all costs of operation. No further allocations therefore are made to other departments or functions.

General Library

Expenditures for libraries maintained separately for instructional departments, organized activities, or organized research projects should be included in the direct expenditures for those units.

The direct expenditures for the central library serving the institution as a whole, exclusive of any amounts that have been charged directly to a department or function, should include salaries and wages, supplies and expense and capital outlay. To these charges should be added the indirect expenditures of previous allocations.

The allocation of total library expenditures may be based on one of many combinations, but perhaps the best allocation basis is the extent of use. This may be determined with the aid of sample surveys conducted periodically during the academic year. Once usage data are determined, according to a department or functions, allocations of total expenditures can be made accordingly.

Organized Activities

The cost of activities is further allocated to the respective activities to determine unit cost thereof.

Student Services

Under student services are included expenditures for registrar, dean of students, dean of men, dean of women, health service, guidance program, and student activities. If any of these offices, such as the registrar, is considered to serve primarily general administrative purposes rather than students, such office may be included under General Administration. Thus, the classification of these items will vary according to institutional organization. The total expenditures for student services are allocated to the departments and functions in direct proportion to the number of full and part time students in each. A portion of the total expenditures may be allocated to extension programs depending upon the nature of the programs and the policies of the university.

Instruction and Departmental Research

In determining the average cost per full-time student equivalent, we are concerned primarily with the direct and indirect costs of instruction. In small liberal arts colleges, in which the instruction of students is practically the sole function, the total direct and indirect costs of instruction divided by the full-time student equivalents may give a fairly accurate average cost unit.

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In large complex universities, however, the instruction of students is frequently supplemented to a great extent by such functions as departmental research, exclusive of organized or separately budgeted research which should be charged directly to "Organized Research", extension and other public service activities. If no deductions are allowed for such non-instructional functions, the average instructional cost per full-time student equivalent automatically is inflated. It would seem appropriate, therefore, to attempt to segregate the expenditures for arts and sciences into instructional and non-instructional categories where the latter constitutes a significant part of the total expense. Non-instructional expenditures could then be allocated to "Extension and Public Service".

The difficulties of segregating instructional and non-instructional expenditures are well recognized and constitute a problem which merits a separate detailed investigation. It is suggested that expenditures for non-instructional activities be estimated by the heads of units in the division of arts and sciences on the basis of percentage of time spent by faculty and staff in such activities and on the approximate cost of supplies and materials used primarily for non-instructional purposes.

In conclusion, I believe that unit costs will be a measure or standard of comparison for the future. Institutional administrators are well aware of the advantages such costs offer and are formulating plans for the use that it deserves. Accountants can take an active part in assisting in their adoption.



Practical Aspects of Accounting and Auditing in Hospitals

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tions, and even these items do not seem to be as variable as the census because of the hospital's preparedness to fill up its accommodations at an hour's notice.

Conclusion for the practitioner:
Whoever is called to advise hospital administrators on their financial planning will have to analyze hospital cost

not only on the basis of a unit computation, but especially on the basis of a determination of the fixed and variable components of the specific hospital cost picture and it might be an interesting pioneering task to develop a standard cost system. Cost variances may be much more helpful to hospital administrators than the present traditional unit cost reports.



Current Trends In Accounting—VI

By LEO ROSENBLUM, C.P.A.

*Some Capsules Reflecting Modern Practices
and Current Problems and Conditions*

Practitioners' Problems

Who Owns the Work Papers?:

Departure from American Precedent

The decision of the Court of Appeal in the British case of *Chantrey Martin & Co. v. Martin*¹ follows in part the decision in the American *Ipswich Mills v. Dillon* that working papers are the property of the accountant who prepares them, not of the client to whose affairs they relate. The *Chantrey Martin* decision took the following point of departure from American practice: correspondence between the accountant and the Inland Revenue relating to the client's tax liability is the property of the client. *Ipswich Mills* held that such correspondence belonged to the accountant.

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On this point *The Accountants Journal*² observes: "There was no United Kingdom precedent, though in the *Ipswich Mills* case it was held that correspondence of this kind belonged to the accountant. The decision of such a court is, of course, of no absolute authority in this country, but would always be treated with great respect. It was, in fact, followed in the opinion which the English Institute took in January 1951, though counsel was at pains to point out that the matter was by no means free from doubt. That doubt has now been resolved by the Court of Appeal."

Accountants' Library

The American Institute of Accountants has prepared a list of "Selected Books for the Accounting Library" which may be bought for approximately \$1,000. A smaller listing, made up of selections from the first one, is available for about \$700. Both lists, obtainable from the Institute, are reproduced in *The Michigan C.P.A.*³

The suggested accessions include volumes on Accounting, Auditing, Budgeting, Business Organization and Management, Commercial Law, Corporations, Cost Accounting, Credit, Depreciation, Government Accounting and Finance, Graphic Methods and Statistics, Internal Audit and Control, Inventory, Investments and Securities, Mathematics and Finance, Professional Problems, Reports and Statements, the Securities and Exchange Commission, Specialized Accounting, Statistics, System Building, Taxation, Valuation,

¹ Referred to in *Current Trends in Accounting-IV* in *The New York Certified Public Accountant*, Vol. XXIII, No. 11, November, 1953, p. 683.

² Vol. XLV, No. 546, August, 1953, p. 260.

³ Vol. V, No. 5, January, 1954, pp. 14-20.

and CPA Examinations. Also included is the Institute's *Accountants' Index*.

Unqualified Opinions for Partnerships and Proprietorships

Walter R. Flack, writing on "The Certification of Proprietorship" in *The Texas Accountant*,⁴ points out that it has never been clearly decided whether "it is proper for an auditor to ever give an unqualified opinion regarding proprietorships, or partnerships, and . . . [certain] close . . . corporations. . . ." Although the large accounting firms "have provided rules for themselves out of necessity" there appears to be little consistency among the firms; on the other hand, smaller practitioners find a dearth of literature on which to rely.

The focal point of the difficulty is the net worth section, since "the proprietor's drawings may be the source of liabilities rather than the extinguishment of them as is experienced by corporations through dividends."

Some CPAs believe that as long as the reader knows, through footnote, statement heading or otherwise, "that the business is a proprietorship" no further precautions are necessary; this is because it is generally known that auditing limitations exist concerning businesses of this sort. Mr. Flack, however, prefers to report the limitation, which he places between the scope and opinion paragraphs of the certificate, as follows: "Because this business entity is a proprietorship, our examination was not extended into any assets or liabilities, real or contingent, of the proprietor other than those reflected in the accompanying statements."

Another important point is the liability for income taxes. Where the auditor has enough information to make an estimate, he should include the

item in the balance sheet. If he cannot do so, "he should include an explanatory note, keyed to the current liabilities section. . . ." Other CPAs, he points out, "prefer to state this and other indeterminate liabilities in the report letter."

Helping a Colleague Who Is Seriously Ill

The Committee on Individual Practitioners of the Connecticut Society of CPAs has reported⁵ a motion made and carried by the Committee providing that the Society organize a "Committee to cooperate with and assist individual practitioners to carry on their practices in case of serious illness or some other disaster befalling a member."

The availability of such help in case of serious illness would add much to the comfort of any member of our own Society temporarily unable to carry on his practice.

For CPA Candidates on Your Staff

The American Institute of Accountants, in cooperation with the Association of CPA Examiners and the American Accounting Association, plans to issue a booklet containing general information for CPA exam candidates, to become available next summer.⁶

The purpose is to help candidates prepare for the examination. The booklet will also serve as a guide to schools and individuals on the requirements for admission to the CPA examination and will explain how the examination is prepared and graded.

Avoid It

Executive director John L. Carey of the Institute, writing in *The CPA*, the Institute's membership bulletin,⁷

⁴ Vol. XXVI, No. 1, January, 1954, p. 10.

⁵ Report for the year 1952-1953, presented in *The Connecticut C.P.A.*, Vol. 17, No. 2, January, 1954, p. 7.

⁶ *The Journal of Accountancy*, Vol. 97, No. 3; March, 1954, p. 269.

⁷ February, 1954, pp. 2-3.

advises CPAs against the performance of these "services of a legal nature . . . [which create] ill feeling between two professions which should cooperate closely": (1) Prepare legal documents like agreements, conveyances, trust instruments, wills, or corporate minutes, or give advice on the legal sufficiency of such documents; (2) Take steps to create, amend or dissolve a partnership, corporation, trust or other legal entity; (3) Advise a client on choice of legal remedies; (4) Describe himself as "tax consultant" or in some similar fashion leaving room for the inference that the accountant "dealt with all aspects of taxation including legal problems"; (5) Advise on legal matters generally.

In brief, "Shoemaker stick to thy last," counsels Mr. Carey.

Accountants as Receivers and Trustees

The Institute's committee on bankruptcy and reorganization is seeking information from accountants throughout the country concerning their experience while serving as receivers or trustees in bankruptcy or corporate reorganization proceedings.⁸

It appears that courts "have had little consideration for the value of service by the accountant and have been arbitrary in reducing fees even below a reasonable minimum."

Popular Subjects

The Maryland Association of CPAs' committee on accounting and auditing procedure finds these the most popular subjects for panel discussions⁹: events subsequent to balance sheet date; testing inventory quantities and prices; cash basis statements and records; confirmation of accounts payable; cent-

less bookkeeping; pros and cons of LIFO; thirteen 28-day months.

Accountants' Round Table

The Georgia Society of CPAs reports that one of its recent Accounting Round Tables was attended by 36 practitioners.¹⁰ They met for dinner, followed by two hours of "uninterrupted animated discussion" covering a wide range of topics.

Our Society, it is to be noted, conducts a monthly luncheon round table on CPAs' office and personnel problems. The meetings take place on the last Tuesday of each month at a mid-town hotel.

"One of the Happiest Features of My Professional Experience"

A chartered accountant made this comment at a session of the Association of Certified and Corporate Accountants' Summer Conference at Folkestone, England:

"The ordinary accountant has a heart as well as a pocket. Many people come to me in the early days of their commercial enterprise and if I were to charge an adequate scale of remuneration for myself, they would never get on their feet. It is extremely doubtful whether I would ever be paid, but this is a circumstance we have got to face. I have been in practice nearly forty years and one of the happiest features of my professional experience is that there were people who came to me when they were starting with small capital, with high hopes and tremendous energy and I have helped them into a sound condition. They are paying jobs for me now. Those small businesses can form quite a substantial part of the ordinary accountant's practice. We could possibly and profitably say there is nothing in this for us and leave it for somebody else. Apart from the pleasure of making a reasonable living, I think we owe a duty to the community as a whole that the young man with the small business is entitled to some consideration on the financial side."¹¹

⁸ Noted in *The Minnesota Certified Public Accountant*, Vol. 2, No. 3, December, 1953, p. 3.

⁹ *CPA News—Bulletin* (of the Maryland Association of CPAs), Vol. 4, No. 4, December, 1953, p. 3.

¹⁰ *Bulletin* (of the Georgia Society of CPAs), Vol. 21, No. 5, January, 1954, p. 3.

¹¹ Comment during discussion of "Organization and Fees in Medium Practices:" paper by R. Sproull. *The Accountants Journal*, Vol. XLV, No. 546, August, 1953, p. 251.

Advice to Young CPAs

In a paper called "Tax Practice and the Young CPA," in the *Pennsylvania CPA Spokesman*,¹² Abraham J. Leonard offers these tax return preparation suggestions to the young CPA:

1. Make full disclosure of unusual tax situations on rider attached to return, and your reason (supported by reference to statutes and regulations) for not including the items or for taking them as deductions.
2. Explain reason for substantial increases in such items as repairs, traveling expense and advertising.
3. Support valuation figures by expert appraisers.
4. Make copious notes on your tax working papers.
5. Give full reasons and references in all journal entries.
6. Examine all papers covering a given transaction to assure yourself that they properly support the tax treatment.
7. Review corporate minutes to make certain that they "tie in" with the tax return.
8. Reconcile income as shown by books with taxable income reported.

Auditing

Sky-view

Recently, to check the value of an inventory of logs in the river on the way to a lumber mill, a CPA combined aviation and photography.¹³ He ran the film off before lumber experts for appraisal.

Different Audit Standards for Small Clients?

Professional standards should not vary as between large and small clients, opines Robert E. Witschey, CPA, in a paper presented before the 1953 Middle Atlantic States Conference of accountants.¹⁴ There is but one ulti-

mate standard, he notes—the assurance in the CPA's mind "that each engagement has been completed in conformance with the accepted practices of the profession." The components of this standard are independence, impartiality, knowledge, and good judgment.

It may be extremely difficult for a public accountant serving small clients who are close personal friends—those with whom he lunches, plays golf, visits, accompanies to church, is associated with in community projects—to maintain independent judgment in every engagement. This is so because as one associates with close friends he "assumes something of the color of [their] . . . ideas." But "a line must be . . . drawn . . . at that point where friendship might interfere with independence of judgment."

As for impartiality—the accountant is "duty bound to make a full and accurate disclosure of the facts as he finds them" even though it be objectionable to the client.

On the subject of knowledge, Mr. Witschey points out that since the practice of accountancy presents increasingly complex problems almost daily, current reading in accounting, auditing, taxation, budgeting, management, and other fields is essential. He advises reading the professional magazines, the Institute's accounting research and auditing bulletins, the *CPA Handbook*, and similar works.

"Standards of ability and training, and therefore of judgment, vary considerably between individuals", observes Mr. Witschey. To help individual practitioners improve the quality of their judgment, he recommends that the profession continue to provide guidance as well as "something against which . . . [the practitioner may] check his opinions and methods."

¹² Vol. XXIV, No. 5, February, 1954, p. 6.

¹³ Noted by Kenneth F. Lacy in "Tax Thinkings" in *The Louisiana Certified Public Accountant*, Vol. XIV, No. 2, November-December, 1953, p. 18, reporting an incident cited by Alexander Eulenberg, CPA, of the Illinois Society.

¹⁴ *The Virginia Accountant*, Vol. VII, No. 3, January, 1954, pp. 4-12, 46.

Predicting Operating Results May Be Dangerous

One of the country's widely-known manufacturing companies reported sales for 1952 of \$327,000,000 and net income after taxes of \$11,000,000.¹⁵ In 1953 sales rose to \$415,000,000, but net income after taxes fell to \$3,400,000.

These problems, among others, developed during the year: a series of strikes, "far exceeding our experience in any like period in the past"; consolidation of various divisions of the company creating "problems of excessive inventories which, under prevailing market conditions, could only be moved by means of substantial price concession. These inventory adjustments proved to be considerably greater than had been originally expected and were the most important single factor which contributed to the lower operating results reported for the fiscal year."

Selecting a School System Auditor

The Austin Chapter of the Texas Society of CPAs has appointed a committee (to become part of a joint committee with the members of the accounting department of the University of Texas) to make "a thorough study, prepare a set of minimum specifications for the school system audit and make recommendations regarding a reasonable and ethical method of selecting an auditing firm."¹⁶

Aids to Clients

Thumbs Down on One-Book Systems for Retailers

J. Sydnor Mitchell, CPA, of Richmond, Virginia, a member of the Council of the Institute and past presi-

dent of the Virginia Society of Public Accountants, writes on "Some Special Problems of the Small Retailer" in *Taxes*.¹⁷

He disapproves of the simplified bookkeeping system, the "one-book affair which appeals to the client as a mark of simplicity."

Usually, he points out, "with the same effort necessary to keep this type of system there could be kept a 'custom-made' double entry set of books from which much more meaningful information may be compiled."

Orientation for Small Manufacturers

The Small Business Administration has issued a pamphlet called "Public Accounting Services for Small Manufacturers", written especially for those unacquainted with the ways in which CPAs can render practical assistance to a business. The booklet may be obtained from the Superintendent of Documents, United States Government Printing Office, Washington 25, D. C., for 15¢.

Tax Incentives in Underdeveloped Countries

E. B. Nortcliffe, writing in *The Accountant*¹⁸, discusses the subject of "Tax Incentives [offered to new industries] in Under-Developed Territories." Some of your clients may be interested.

The territories considered are Nigeria, Gold Coast, Sierra Leone and Gambia, British East Africa, Belgian Congo, French Equatorial Africa, French West Africa, India, Pakistan, Ceylon, British West Indies, Philippines, Cuba, Lebanon, Egypt, and Israel.

Mr. Nortcliffe summarizes his comments with a tabular schedule showing the territory, the tax rate on profits, the exemption of profits allowed, pro-

¹⁵ Avco Manufacturing Corporation, 25th Annual Report, 1953.

¹⁶ *The Texas Accountant*, Vol. XXV, No. 12, December, 1953, p. 8.

¹⁷ Vol. 32, No. 3, March, 1954, pp. 246-255.

¹⁸ Vol. CXXX, No. 4131, February 20, 1954, pp. 198-205.

visions for accelerated depreciation, and other types of relief.¹⁹

"Doubts have been expressed", he points out, "about the wisdom of attracting new industries by means of direct tax reliefs . . ." since industries "which will never be able to stand on their own feet" might be set up. However, he continues, "this type of incentive is now extensively used, and whatever the views of capital-exporting countries may be on this question, they would be wrong to thwart the deliberate policies of the under-developed territories."²⁰

Budgets

M. B. T. Davies, CPA and chartered accountant, and assistant controller of Deep Rock Oil Corporation, of Tulsa, Oklahoma, presented a paper on budgeting before a recent meeting of the Tulsa chapter of the Institute of Internal Auditors.²¹ He recommended aiding clients to introduce budgets.

Though budgets are relatively simple procedures once in effect, the most difficult tasks are probably to sell the businessman on the need for assistance, helping him install it, and ironing out the preliminary difficulties. Clients' opposition arises from fear of budget techniques and cost, unwillingness to venture into something new, and inability to forecast sales or other income. These misgivings should not be difficult to overcome.

Four elements, all involving forecasts, enter into budget construction: earnings, capital expenditures, income tax, and cash. Mr. Davies discussed each of these at length.

Management Services by CPA Firms

H. T. McAnly, CPA, and general partner of Ernst and Ernst, of Cleve-

land, discussed "Management Services of an Accounting Firm" at the 14th Annual Symposium on Accounting and Taxation, held by the North Carolina Association of CPAs last Fall.²²

Mr. McAnly considered in turn these subjects comprising the "complete management service" a public accounting firm might render to business: cost accounting and engineering; personnel consulting; marketing; revision in accounting and cost procedures; budgetary control; review of clerical procedures; compensation plans; personnel administration; production control; statistical quality control; review of shop practices.

To provide such service the accounting firm's staff would have to include accountants, cost accountants, systematizers, procedures specialists in mechanical and electronic equipment application, marketing specialists, engineers, and personnel consultants.

With these specialists operating as a team business would be offered "the equivalent of a staff organization to advise and assist in the solution of a specific or an over-all operating problem."

Management Accounting: Great Britain

James Blakey, chartered accountant, president of the Institute of Chartered Accountants in England and Wales, made this observation at the annual dinner of the Liverpool Society of Chartered Accountants this winter:²³

"Practically all this work [management accounting] is eminently suitable for and comes within the ambit of our professional qualifications. Many firms of chartered accountants have departments which specialize in this activity, but naturally it cannot be advertised and hence we are at a disadvantage as against the management consultant who uses methods which would

¹⁹ *Ibid.*, p. 205.

²⁰ *Ibid.*, p. 204.

²¹ *The Certified Public Accountant* (bulletin of the Oklahoma Society of CPAs), Vol. 9, No. 6, January, 1954, pp. 1, 3.

²² *The Virginia Accountant*, Vol. VII, No. 3, January, 1954, pp. 22-34.

²³ *The Accountant*, Vol. CXXIX, No. 4121, December 12, 1953, p. 670.

not be considered ethical by our standards.

"Without in the least underrating the value of management accounting, there is no magic in it and like much of other specialized work, it is common sense and a projection of the fundamental training which every chartered accountant receives, and can be carried out by the accountant in his own practice or in his capacity as a full-time employee in a commercial concern. It implies making use of the current records of a business, both financial and technical, rather than a study of the events of the past with which our member as an auditor is normally concerned."

A Banker on the CPA's Work

Arthur L. Nash, assistant manager, Brown Bros., Harriman & Co., investment bankers, of New York City, writes on the "Relationship of the Lawyer, CPA and Banker in Business Planning" in *Taxes*.²⁴ CPAs can assist management, he points out, in these areas: taxes; long-range forecast; periodic audits; budget preparation; review of purchasing program and controls on commitments; advice on internal control; material controls; cost control; pension and other fringe benefits.

Mr. Nash advises bankers and lawyers to read these Institute pamphlets so that they may become more familiar "with the standards under which accountants operate": the "red book" (*Audits by Certified Public Accountants*), the "blue book" (*Codification of Statements on Auditing Procedures*), and the "green book" (*Restatement of Accounting Research Bulletins*).

Mr. Nash cautions that bankers "cannot expect . . . a detailed audit costing several thousand dollars when the client only wants to spend \$500". But they may expect that accountants will: (1) Adhere to the ethics and standards of the profession; (2) Indicate clearly the scope of audit; (3) Make full disclosure of all material

facts in reports; (4) Be unequivocal in opinion or disclaimer of opinion.

Taxation

If They Hit You It's Deductible

Prentice-Hall's *Accountant's Weekly Report*,²⁵ points out that when another automobile causes damage to your car or property the loss is deductible.²⁶

However, the publication continues, "it's equally clear that payment by the taxpayer for damages to another's property or personal injuries resulting from an automobile accident are not deductible as casualty losses."²⁷ Briefly, if they hit you, it's deductible; if you hit them, it's not a deductible casualty loss.

Should the Jury Be Informed?

In the April, 1953, issue of *The New York Certified Public Accountant*, "Current Trends in Accounting" included a reference to the case of *Dempsey v. Thompson* (251 S. W. (2d) 42, Missouri, 1952) where the Court held that it was proper to inform the jury that the verdict in a personal injury action would be tax-free. In *The Monthly Digest of Tax Articles*²⁸ the question is posed: "Should a jury in a personal injury action be allowed to consider that its award will be tax-free?" Most jurisdictions say "no", the matter being too speculative. But in *Dempsey v. Thompson*, "a precautionary instruction that the award was not subject to income tax was allowed."

Pointing out that an article in the *Texas Law Review* (November, 1953) concurred, the *Monthly Digest* offers sharp dissent. The jury in a personal injury case, it is pointed out, must evaluate: "(1) conscious pain and suffering, and (2) effects of permanency." The tax benefits, it is further stated, in no way mitigate these. Allowing a jury to consider the tax

²⁴ Vol. 32, No. 3, March, 1954, pp. 236-241.

²⁵ Vol. 12, No. 25, Section 1, March 8, 1954, p. 4.

²⁶ Citing *Shearer*, CA-2, 16 F.2d 995, 6 AFTR 6483.

²⁷ Citing *Stern*, USDC, N.D., Ohio 12/18/53; *Stoll*, TC Memo, 8/19/46.

²⁸ See "Tax Digest Letter", Vol. 4, No. 6, March, 1954, pp. 19-20.

exemption in making an award would "actually . . . reduce that award by considerations which are no part of the case." Finally, it is noted: "There are many categories of tax-free services" . . . (;) and "To reduce them because they are tax-free is a complete non-sequiter."

Contributions: Blood Donation

No deduction for tax purposes results from one's giving his life blood, points out *The Connecticut CPA*.²⁰ Commenting on Internal Revenue Ruling 162, the magazine points out that furnishing of blood to a blood bank is considered analogous to offering a personal service; is not deemed a contribution of property. Thus an individual cannot deduct as a charitable contribution the fair market value of his blood donation to a charitable organization.

Solid Foundation in Tax Theory

An editorial in the *Bulletin of the Washington Society of Certified Public Accountants*³⁰ observes that the CPA profession "has earned more prestige for its proficiency in income taxes than in auditing." But, queries the editorial, "What are the universities and colleges doing for the undergraduate accounting major to give him a solid foundation in tax theory?"

Every graduate is not 'expected to become a tax practitioner. But he should be trained in "fundamentals of taxable income, substance vs. form, business purpose rule, multiple business tax savings, the important elections available to taxpayers" and should also be instructed in tax research. These points, the editorial notes, "are beneficial . . . to the graduate entering private accounting [as

well as the one entering] . . . public accounting".

Insolvent Debtor

Sydney Krause, a lawyer, writes on "Out-of-Court Settlements vs. Chap. XI" in *Credit Executive*.³¹ "The perennial problem" of debtors as to "when to proceed by out-of-court settlement and when by Chapter XI Bankruptcy Arrangement" now has a new facet, introduced by the decision in *Siegmund Schall v. Commissioner*.³² Here the method of computing a loss carry-back was involved.

"At first blush", notes Mr. Krause, "it might appear that the computation of the amount of a loss carry-forward or a loss carry-back could not be affected by the means adopted for effectuating a settlement." But the decision in the *Schall* case appears to indicate otherwise.

The debtor made a 50% out-of-court settlement with creditors in 1948, and computed his loss carry-back without giving effect to the saving realized from the settlement. The Tax Court held that the Commissioner was right "in excluding one-half of the debts due ordinary creditors in computing the carry-back deduction." Thus, the Court held further that the debtor's loss for 1948 could include only 50% of his ordinary debts.

Had the same settlement (50%) been made in a Chapter XI Bankruptcy Arrangement proceeding, "it would seem that a diametrically opposite result would have to be reached."

Of course, notes Mr. Krause in concluding his paper, "It is not suggested that this factor will, in every instance, be determinative of the forum to be selected or the means to be adopted to accomplish a particular settlement."

²⁰ Vol. 17, No. 2, January, 1954, p. 4.

³⁰ Vol. XIII, No. 2, November-December, 1953, p. 2.

³¹ Vol. 47, No. 1, January, 1954, pp. 22, 24.

³² 12 T.C.M., Docket No. 35869, entered November 16, 1953.

Averaging Income

In a letter to the editor of *Taxes*,³³ J. S. Seidman, CPA, of our Society, offers a plan to average income and eliminate income tax inequities.

Two people making the same amount of money over the same period of time, notes Mr. Seidman, may find themselves compelled to pay quite different amounts of income tax. Income taxes being figured on a year-to-year basis and "determined by mounting rate brackets", one who earns his income regularly and in substantially the same amounts comes out well but one who is in a business or other activity where greater risks exist may discover that his earnings are large in one year and small in others, as a result of which the tax brackets will run up his tax in the good year despite the fact that there were also lean years.

Mr. Seidman suggests that the income be averaged on the following basis:

- (1) If the income for the current year is *lower* than the average income for the preceding six years, figure the tax on the income for the current year, just as is now done.
- (2) If the income for the current year is *greater* than the average income for the preceding six years, figure the tax on the basis of the average income for all seven years.
- (3) Figure the tax with the use of the current rates only, and in this way: Seven times the tax on the average income for the seven-year period, less six times the tax on the average income for the six-year period.

Offering computations to illustrate how this will work, Mr. Seidman notes that his plan does not require refiguring for prior years nor special rate tables, nor freezing of income brackets. Further, it offers the advantages that no tax need be paid when there is no income and that there is no refund for prior years.

The "technical things" which come

up under his suggestion are outlined and methods of disposing of them suggested.

What will the effect be on the total revenues collected by the government? In a static economy — with "everything . . . the same after this significant tax change as before", the revenue would be less. But in a "mighty dynamic" economy like ours any tax change which "eliminates the penalty on risk-taking or fluctuating income can be counted on to release energy and initiative that will develop more income and revenue than ever before." Thus, it might well be that the government's revenues would be larger, rather than smaller.

Mr. Seidman concludes that his plan "corrects most of . . . [the] inequity, and does it in a simple, practical way."

Tax Morals

The "Letters to the Editor" columns of the British magazine *Accountancy* contain interesting material on the subject of the moral justification "in using any means to evade taxation provided it be within the letter of the law."³⁴

Metcalf Collier, a practicing accountant and a lay preacher, reports his distress that "both a clergyman and an accountant should apparently assent to the proposition that a business man is acting immorally or unethically if he pays the tax which the law requires without seeking to add something to it which the law does not require."

Reverend Allan D. Rogers, commenting on Mr. Collier's letter, observes: "The fact that the letter of the law has been adhered to is not in itself proof that justice has been done;" and he discusses the principles of moral theology involved.

P. E. Spicer, an accountant, also opposes Mr. Collier's position, commenting:

³³ Vol. 32, No. 3, March, 1954, pp. 206-209.

³⁴ Vol. LXV (Vol. 16 New Series), No. 725, January, 1954, p. 32.

"As a general proposition it is, of course, true that the legality of an action overrides all other considerations, but exceptional cases must arise from time to time, which are so artificial in character and which are based on such doubtful ethics as to render them undesirable, if not technically unjustifiable.

"It may resolve into a question of 'good form' or 'good taste' rather than morals, but, in the end, it comes to much the same thing."

Reports

Long-Form Audit Reports

At the Oklahoma Society of CPAs' Fall Institute, Verden R. Draper, CPA, presented a critical appraisal of long-form reports and some suggestions for improving them.³⁵ The preparation of a good long-form report, all will agree, "takes a substantial amount of time and is an expensive part of the audit." Therefore, if the information in the report "is already available to the client and can serve little or no additional purpose, the client should be consulted to see whether or not the long-form report can be dispensed with and replaced by the short-form report."

The contents of the long-form report were considered in detail. Following the accountants' opinion is the body of the report, which opens with the "history and organization" of the client. Thereafter, appear comments on the company's operations during the year under review.

Then the changes in financial position are considered. This section might include a condensed comparative summary of the company's financial position at the beginning and end of the year; also, significant balance sheet items and changes may be explained.

Mr. Draper notes our tendency to use tabulations to excess; also, too frequently the tabulations are separated

by relatively brief discussions made up of "unduly repetitious" phrases contributing little information.

After the comments on operating results and financial position may appear a section on accounting procedures and internal control. Alternatively, these points may be covered in a separate letter or memorandum.

Then come the financial statements, made up of two parts: general purpose statements (namely the balance sheet, the income statement, and the statement of retained earnings), and the special purpose statements (including details of cost of goods sold, selling expenses, general administrative expenses, and similar matters).

Mr. Draper concludes with these recommendations concerning the preparation of audit reports:

- (1) Examine the language of the report critically.
- (2) Eliminate pennies from the report and statements.
- (3) Try to adopt the terminology recommended by the Institute's Committee on Accounting Procedure.
- (4) Prepare a draft report at the client's office. (This will generally render unnecessary return to the client's office should questions develop).
- (5) As the audit progresses the senior in charge should make notes of points to be considered in the final report.
- (6) Keep the comments, notes, and statements simple.
- (7) Avoid copying the wording of last year's report.
- (8) No material should be included that cannot be substantiated by information contained in the work papers.

³⁵ Reported in the *Illinois Certified Public Accountant*, Vol. XVI, No. 2, December, 1953, pp. 25-34.

- (9) Inspect printed annual reports to stockholders; they will help you "present your findings in a simple and factual manner." Note particularly how charts and graphs are used in these reports.

**"The American Form . . .
[Is] Better"**

An item in the "Notes and Comments" section of the New Zealand Society of Accountants' *Accountants' Journal*³⁶ discusses the form of auditor's report under the United Kingdom Companies Act of 1948. The form includes, of course, the words: "to the best of our information and according to the explanations given to us."

Presenting the standard short-form report recommended by the American Institute of Accountants, the commentator observes: "Possibly British and New Zealand accountants can learn something from their American friends."

And he concludes: "Although there are naturally differences of terminology between both the present and the proposed British form and the American one, it seems to us that the American form gives a much better indication to company shareholders of what the auditors have done and what responsibility they accept."

More on Post-Balance Sheet Events³⁷

George O. Sparks, Jr., writing in *CPA News-Bulletin*, publication of the Maryland Association of CPAs,³⁸ comments: "It would be difficult indeed to find a principle upon which more auditors will agree as to importance and yet differ as much as to scope and procedure than . . . the problem of the disclosure of post-balance sheet events."

After considering the SEC's position on the matter, he points out the several positions existing among accountants today. One group advocates complete examination of the records from the close of the period under review up to the date of the delivery of the report; another takes the position that each year should stand on its own. Thus the latter group believes that the report of a given period "should not be unduly influenced by the occurrence of subsequent events." However, still a third group, taking a "neutral path," believes that disclosure should be made of any material event coming to the auditor's attention, but the examiner "should not indulge in a searching examination in order to turn up important events of the subsequent period." And from among these divergent views must the members of the profession make their choice!

There seems to be little disagreement within the profession on the disclosure of subsequent items which affect prior figures, states Mr. Sparks. But the "big difference of opinion" is found when the post-balance sheet events "would not influence the final result of the report but would simply indicate a possible change in the results for the coming year."

Mr. Sparks concludes that the most reasonable procedure is to recognize that all items which bear on the financial statements and make them better presentations should be expressed therein. But such items as are required to be stated to make financial statements fair presentations, or to keep them from being misleading, must be stated. Finally, of course, the judgment of the auditor must prevail: "he will be influenced considerably by the purpose for which the report is being prepared and by the high standards established by the profession."

³⁶ Vol. 32, No. 4, November 2, 1953, pp. 116-117.

³⁷ See "Current Trends in Accounting—IV," in *The New York Certified Public Accountant*, Vol. XXIII, No. 11, November, 1953, p. 690.

³⁸ Vol. 4, No. 5, January, 1954, p. 3.

Reciprocal Influence

David W. Rewick, CPA, resident manager of the Utah office of Ernst & Ernst, addressed the Utah Association of CPAs on the influence of the SEC on the public accounting profession.³⁹ He "does not believe the Commission will engage in outright regulation of the accounting profession." But in a number of areas the SEC and practicing accountants have exerted somewhat reciprocal influence. Here are several examples:

(1) The "special item" and "net income or loss and special item" wording has resulted out of the "divergent opinions between the SEC and certified public accountants."

(2) The SEC has announced its conclusion that operations should be charged with depreciation based on cost rather than on replacement value.

(3) The SEC has in effect become both judge and jury. Consider the decision in the *Thomascolor* case. Here the SEC "established a dangerous precedent of acting as both a judge and jury, without giving due regard to evidence contrary to the SEC's eventual decision."

(4) The SEC has recently attempted to require certain unlisted corporations to file annual reports.

Although the SEC exerts "a direct or indirect influence upon all practicing accountants", Mr. Rewick concluded, it is "one of the best friends of the accounting profession[;] there is no reason why this cooperative relationship will not continue. . . ."

Ethics

Competitive Bidding: New Jersey

This is the text of the revision of Rule 12 of the New Jersey State

Board of Public Accountants' Rules of Professional Conduct:

"Competitive bidding is deemed to be detrimental to the interests of the public and the accounting profession. No practitioner shall knowingly, directly, or indirectly, enter into bidding for any type of professional service in competition with other practitioners on any basis whatsoever. A competitive bid for professional engagements is defined as: An offer made to a person or organization not a regular client to perform a specified service for a specified sum, with the knowledge that a similar offer or offers are being solicited of another practitioner or practitioners. *The fact that a practitioner is solicited to make an offer to perform a service for a stipulated fee by a person or organization which is not already a client of the practitioner so solicited is indicative that similar offers are being solicited, and it shall be incumbent upon the practitioner to reasonably assure himself to the contrary by direct question to the solicitor before making an offer to perform such services*" (emphasis added).

Kentucky

The revised regulations of the Kentucky State Board of Accountancy require⁴⁰ the applicant to submit with his application "satisfactory answers to questions on the Kentucky Accountancy Act . . . and answers to questions on the official Code of Ethics, such questions being furnished by the Board."⁴¹

Too Much Advertising

The Institute's Committee on Professional Ethics found that the following condition would be in violation of Rule 10.⁴²

A member had established part-time offices in three cities and had published a proper announcement in local newspapers of each, indicating the opening of the part-time offices. He wished to know whether he might, just before the approach of the busy season, insert further newspaper advertisements indicating the dates and hours at which

³⁹ *The Utah C.P.A.*, Vol. 10, No. 1, December, 1953, p. 3.

⁴⁰ *The Kentucky Accountant*, Vol. 6, No. 2, September-October, 1953, p. 6.

⁴¹ Regulation SBA 2-B(2).

⁴² *The CPA*, February, 1954, p. 14.

he would be at his offices in the various cities.

Machine Accounting; Electronics Machines

Readers will find it profitable to consult *The Hopper*, official publication of the National Machine Accountants Association.

The January, 1954, issue,⁴³ for example, contains articles on the federal excise tax on tabulating machine rentals, electronics for the office, written procedures in offices, a new comprehensive machine rental plan, and a detailed account of the system employed by a nationally-known sports clothing and products company in connection with its order and invoice system. The last-named article presents in detail the company's invoicing procedure, describing the routine followed in processing orders for shipment, including the preparation and distribution of the shipping order after it has been prepared in the order department.

The issue also contains a section of "Tips and Pointers" on office procedures. These include a note by Thomas K. Baer of the Lybrand, Ross Bros. & Montgomery office in Louisville, Kentucky, concerning a composite general ledger used in punched card accounting installations. Other notes deal with the use of mark-sensing to correct property records and the preparation of time cards on the tabulator.

Light on the Future

One of the business machines companies has prepared a pamphlet called "Light on the Future,"⁴⁴ containing a glossary of the new terms (dealing with electronic accounting) met so frequently in newspapers and accounting magazines.

Binary digits, analogue computers, accumulators, digital computers, magnetic drum, stored program, and other

terms are defined in the publication, whose principal sections are designated as follows: Two Families of Computers (analogue computers; digital computers); Organization of Digital Computers; New Developments; What's Next?"

Electronic Accounting

Dr. John W. Mauchly, one of the inventors of UNIVAC, an electronic calculating system, writes on "Electronic Accounting" in *The Hopper*.⁴⁵

The speed with which electronic equipment can perform mathematical operations is not the only consideration, he points out. What is more significant is the cost of the entire accounting operation.

Electronic devices are not merely computers; "automatic clerical equipment" describes better what is done.

The UNIVAC system employs magnetic recording on metal tapes. This is "more like a teletype tape than a sound recording tape." A piece of the tape, under an inch in length, "is equivalent in its storage capacity to any of the common forms of punched card."

Unlike punched card devices, which are specialized, an electronic system's central processing unit "[can] carry out an exceedingly long and complex sequence of operations, once that sequence has been written down explicitly and stored on magnetic tape. . . ."

While card equipment users "devise all sorts of control totals and card counts to detect faulty operation", the UNIVAC system "incorporates built-in checking devices which constantly and automatically monitor every operation, from the time that information is first recorded on tape to the time that printed results are obtained."

Of most interest to accountants is the question: "Can business office operating costs be reduced by using electronic office equipment?" This

⁴³ Vol. 5, No. 1.

⁴⁴ International Business Machines Corporation, 1953, 30 pp.

⁴⁵ Vol. 4, No. 11, December, 1953, pp. 2-4. Also see note 43, above.

can only be answered by studying the specific operations of a particular company. Of course, manufacturers of electronic equipment invite consultation on the point.

Electronics in Retailing

"Electronics—New Horizon in Retailing" is the title of a research study prepared at the Harvard Graduate School of Business Administration.⁴⁶

The authors, students at the School, consider in detail punched card electro-mechanical systems, recent advances in punch card procedures, and applications of electronics to retail record-keeping.

Under the subject of punched card electro-mechanical systems, they discuss: retail control uses of such system; standard punched cards as merchandise tags in the store; department store use of punched cards for unit control; the experiences of various stores with punched card and manual systems.

Under punched card procedures are considered: mark-sensed cards; punched price tags; branch store information handling; cash register tape development; and the basic weaknesses of punched cards and punched card systems.

The researchers' conclusions⁴⁷ merit careful review by members of our Society whose clients include retailers.

Economics; Accounting Theory National Income

Charles Lawrence, CPA, assistant professor of accounting at Michigan State College, discusses "Some Accounting Aspects of National Income Computations" in the *Illinois Certified Public Accountant*.⁴⁸ He considers the differences between traditional accounting concepts of income and those

used in "national income" computations.

The major areas of difference are as follows:

(1) Accounting income calculations are based upon matching of costs and related revenues. But under national accounting "income represents a simple aggregate—the total flow of payments of value to certain elements of production."

(2) Objective accounting data have different degrees of usefulness for economics and accountants. Income calculations made for business "are based upon a concept which requires the use of all the reported objective data concerning a given business." But economists "interpose . . . qualifications on the accounting data suitable for use in national income purposes." (Professor Lawrence discusses these qualifications.)

(3) Economists use different reporting units and a different standard of measurement.

Accountants, the professor concludes, should be vitally interested in these basic differences. It is important to "distinguish the implications of the reported national 'income' . . . for the business sector and for the nation as a whole. Income as businessmen use the term does not seem to be involved."

Statistics

J. A. Reece, fellow, Institute of Cost and Works Accountants, London, and a statistician, has prepared a paper on "Statistics for the Cost Accountant."⁴⁹ The paper shows "how statistics is used in work of particular interest to cost accountants."

Mr. Reece points out how statistics fit in common management problems, what may be expected from them;

⁴⁶ Edison, Julian E.; Morse, Lester S.; Pizitz, Richard A.; and Sternlieb, George, Boston, Massachusetts, 1953 (Research Study submitted to the Harvard Graduate School of Business Administration), 94 pp.

⁴⁷ See pp. 89-91 of the work.

⁴⁸ Vol. XVI, No. 2, December, 1953, pp. 44-49, 53.

⁴⁹ Institute of Cost and Works Accountants, London, 1954.

stressed particularly is the relationship of statistics to cost accounting.

He comments: "The cost accountant has to decide when to probe into the variations shown in his cost statements. . . . [A]fter a time a special feeling is developed for differences that indicate serious changes in the works [factory]."

"At any given time", he observes further, "the main problem is to know if something out of the ordinary has happened so as to cause a more than expected variation in costs." For this purpose statistical technique "can set out results in such a way as to show clearly if a significant trend or deviation has occurred, relative to the current normal variations."

This brief work (40 pages) is recommended to our members. It is distributed by Gee and Company, Ltd., 27-28 Basinghall Street, London, E. C. 2.

Price Level Changes: Depreciation

The Association of Certified and Corporate Accountants, London, has prepared a memorandum on "Accounting in Relation to Changes in the Purchasing Power of Money."⁵⁰ The observations on depreciation are particularly significant. The object of the charge for depreciation "is not to provide for a fund for replacing the asset (although that may be its incidental and useful result) but for accounting as an expense the cost of using it up. Depreciation is . . . the recovery, spread over the life of the asset, of the prepaid cost incurred by acquisition." Accordingly, the organization points out, "an annual charge which will do this is the minimum . . . [to be] charged against current operations during the useful life of the asset. But if—owing to the inflationary rise in prices—this charge is lower than it would be if it were calculated on the same basis as other items of expenditure, e.g., maintenance and

repair, then expenses are understated and profits overstated."

The organization suggests this remedy: the depreciation charge can be divided into two parts, the first, a basic charge "calculated on recorded cost and designed to cover it over the useful life of the asset," and the second, a supplementary charge. The latter would be the difference "by which the basic charge falls short of the amount which would appear as an expense if it were calculated on a basis homogeneous with maintenance, repair and other current expenses."

This procedure would pose no great technical difficulties "nor cause a breach in the structure of accounting principles," the Association notes further. The system of accounts would be unchanged under this procedure "up to and including the trading or manufacturing account," since at this point the basic depreciation would have been accounted for. The remainder, the trading profit, "could be brought to a depreciation adjustment account where the supplementary depreciation could be charged," the balance being carried to the profit and loss account. As before, the basic depreciation would be deducted in the balance sheet; the supplementary depreciation would be shown in a special replacement provision account.

Depreciation Unnecessary?

In correspondence to the magazine, *The Accountant*,⁵¹ P. J. Tombleson, industrial accountant, reveals his doubts about the need for setting up depreciation computations: "I would like . . . to confess to being so unorthodox as not to believe in depreciation for the average business."

Recalling his twenty years of industrial accounting experience, Mr. Tombleson comments, "I have yet to meet the case where a machine has worn itself out beyond the possibility

⁵⁰ Press Release, 1953.

⁵¹ Vol. CXXX, No. 4127, January 23, 1954, p. 97.

of piecemeal repair." In all but one case in 100, "the decision whether to replace plant or not is governed by whether the new plant is capable of earning so much more than the old plant that its capital cost can be recouped reasonably quickly." Factors involved are, of course, comparative operating cost, cost of maintenance and repair of the old plant, and the necessity for obtaining higher output or some other advantage over competitors.

All of these, this correspondent continues, "are . . . obsolescence matters;" talking of physical depreciation and the recovery of cost over the life of the asset "seems . . . to be the sort of accounting moonshine which a practical works [factory] man would scoff at."

Of course, he points out, there are exceptional cases, for example, those dealing with leases, where true depreciation does occur.

General

Fastest-Growing Profession

A news release from the American Institute of Accountants⁵² reports that there are over fifty thousand CPAs in the country at present in contrast with the twenty thousand of 1940. One-fourth of the country's CPAs are in our own State; 58 per cent are to be found in the six states of New York, California, Illinois, Pennsylvania, New Jersey, and Texas.

At the beginning of the century there were only 243 CPAs in the country; by 1920 the number had grown to 5,000. But between World War I and World War II the number rose more than 300 per cent. And in the last thirty years the total skyrocketed about 1,000 per cent.

It is estimated that the number of CPAs will double within the next ten or fifteen years.

⁵² January 24, 1954.

⁵³ *The CPA*, March, 1954, p. 5.

⁵⁴ Vol. XXXIII, No. 52, December 28, 1953, p. 9.

More Statistics

The question has often been asked "How many CPAs are engaged in public practice?" The Institute has prepared these statistics showing the occupational break-down of its membership:⁵³

Partners and individual practitioners	11,746
Employees of accounting firms	5,761
Private corporations	3,794
Government employees	569
Teachers	371
Military service	79
Unclassified	120
Total	<u>22,440</u>

Stock Corporation Law Booby-Trap

Dwight Rogers and Donald F. McManus, writing in *Barron's*,⁵⁴ point out that our State's stock corporation law is loaded against the unwary investor. The law "holds every stockholder of a New York Corporation to the full liability of a general partner for certain 'wage' claims, which may include salaries, severance pay, pensions, and practically every kind of employee fringe benefit one can think of." Claimants who seek to avail themselves of this wage claim provision must notify stockholders within 30 days of the time wages became due.

This infrequently-referred-to section of an over-100-year-old law—Section 71—was broadened as recently as 1952. It was invoked in 1950 against a number of stockholders of a defunct New York City newspaper.

It is to be noted that the little-used section makes no distinction among types of organizations, *i.e.*, publishing,

merchandising, or manufacturing companies, nor among the various classes of stock, nor between stock acquired by gift and that purchased.

Abandoning the Voucher-Type Audit

"Auditing in government . . . is rapidly changing from the old voucher-type audit to a selective approach comparable to that practiced by certified public accountants in their audits of industrial and commercial concerns," notes X. Bender Tansill, CPA, Chief of the Internal Audit Division, Chicago Regional Office, Army Audit Agency, writing on "The Comptroller Function in Government," in *The Illinois Certified Public Accountant*.⁵⁵ And more and more CPAs are joining the government's staff to direct and supervise this work.

Further, the Army Audit Agency has inaugurated a training program to "prepare otherwise qualified accounting and auditing personnel in the techniques of internal auditing and in contract cost accounting. . . ." The program will be installed and supervised by a large CPA firm.

It is quite clear that the government has started "a movement to improve its budgeting and accounting systems." Formerly accounting was of the single-entry or cash book type. But this has all changed; "Congress now recognizes the necessity of following through to find out what is accomplished with the monies spent."

Government Accounting: Great Britain

Sir Frank Tribe, British Comptroller and Auditor-General, lectured before the London and District Society of Chartered Accountants on January 5, 1954, on the subject "Parliamentary Control of Public Expenditures."⁵⁶ Comptroller of Her Majesty's Exchequer, he discussed the system of accountability in use for Parliamentary funds. Sir Frank's own audit of the accounts of government departments is made up, he pointed out, of three different types of audits. The first is the accounting audit, which is like that undertaken by public accountants; the second, the normal finance audit, which covers control over expenditures—whether internal audit is adequate, whether the stores accounting is adequate, whether there is a proper system of collecting all receipts due, and whether there are losses due to failure to safeguard cash or stores; and third, the appropriation audit, to determine, among other things, whether any expenditures are not in accord with Parliament's intention.

Busman's Holiday

It is reported that the Hawaii Society of Certified Public Accountants would like to invite speakers from the United States to address its members. If you plan a vacation or business trip in Hawaii—or know some outstanding businessman who is contemplating one—this opportunity to talk abroad may be of interest.⁵⁷

⁵⁵ Vol. XVI, No. 2, December, 1953, pp. 35-41, 43, at p. 40.

⁵⁶ *The Accountant*, Vol. CXXX, No. 4127, January 23, 1954, pp. 87-91.

⁵⁷ *The C.P.A. Newsletter* (of the California Society of CPAs), Vol. 7, No. 5, December, 1953, p. 3.



New York State Tax Forum

Conducted by BENJAMIN HARROW, C.P.A.

Taxation of Annuities

The 1954 Legislature¹ amended Section 353.6 of the Income Tax law relating to the ascertainment of gain and loss on joint and survivor annuities. This section provides that the survivor's interest in such an annuity shall be deemed to be property acquired by bequest, devise or inheritance from the decedent if the value of any part of such interest was required to be included in determining the value of the decedent's gross estate for purposes of estate taxation.

The Legislature² also amended Section 359(a) (b) defining gross income and exclusions. The amendment provides that the cost or basis of a survivor's annuity includible in the first annuitant's estate shall be the value as of the date of death of the first annui-

tant. Amounts received by the survivor annuitant will therefore be included in income to the extent of 3% of such basis. The excess is excluded until the total exclusions equal the basis, after which all amounts received are taxable.

Before the amendment, the basis for determining the taxable portion of the joint and survivor annuity was the cost of the annuity.

It is interesting to compare this treatment of joint and survivor annuities with the proposed Code of 1954. The new Code establishes an exclusion ratio for all annuities. This is determined by taking the ratio of the cost of the annuity contract to the expected return on the annuity. The latter amount is the annual payment multiplied by the life expectancy of the lives of all the annuitants. In other words, the cost of the annuity is to be recovered without tax over the period of the life expectancy of the annuitants. The balance is taxable income. The excludable portion remains constant regardless of the number of years the annuitants actually live. If this becomes law we may expect the next Legislature to follow it.

Partner's Salary

The salary of a partner has long been considered as part of the distributive share of partnership profits and not a deductible business expense. During 1953, the Attorney General ruled³ that the salary paid to an employee of a theatrical partnership is a deductible expense of the partnership business, even though the employee is also a limited partner who does not participate in the management of the partner-

BENJAMIN HARROW, C.P.A., has been a member of our Society since 1928. He is a Professor of Law at St. John's University.

Mr. Harrow has been a member of the American Institute of Accountants since 1922 and is a member of the New York Bar. He is a past Vice-President of the Society and is now serving on the Society's Committees on Awards and Publications. He is a past Chairman of its Committee on State Taxation. He is also a member of the Institute's Committee on Federal Taxation.

Mr. Harrow is engaged in practice as a certified public accountant and attorney in his own office in New York City.

¹ Ch. 363, Laws of 1954.

² Ch. 363, Laws of 1954.

³ July 15, 1953.

ship's affairs. This is a slight concession to business practice.

A more radical change is in prospect in the proposed Code of 1954. One section of the law provides that payments to a partner for services shall be considered as a salary paid or incurred and includible in the gross income of the partner as salary, without regard to the income of the partnership to be distributed as partnership profits.

Loss of Classification as a Real Estate Company

A real estate corporation is limited to certain specific activities if it wishes to retain its classification as such. Two situations were called to our attention relating to these activities. In the first case the corporation was engaged in constructing one family houses and selling them. Is that a permissive activity? By definition, a real estate company is one that is engaged in the purchase and sale of real estate and holding title to real estate for itself. It is true that construction activities may be considered as a separate business, but since the end result of the construction is to create the real estate that will be sold, the Tax Commission has given a liberal construction to such activities and has not disturbed the classification of such a corporation.

The second case is one where a real estate corporation has loaned money to an officer in an amount not in excess of 10% of the average gross assets. Is that act permissible? The 10% provision in the law relates to ownership of stocks, bonds or other securities. A loan to an officer would not come within this classification and in our opinion would result in a loss of classification if not repaid within a reasonable time.

Since 1948 a real estate company has been permitted to make loans to wholly owned subsidiary real estate corporations taxable under Article 9,

but even in such cases the loans plus stocks and securities must be within the limitation of 10% of the average gross assets during the year.

Estate Tax—Insurance Proceeds and Power of Appointment

A decedent was the beneficiary of a life insurance policy issued to her father in 1912. Under the insurance contract the proceeds were to be retained by the insurance company and the beneficiary was to receive an annuity of 3% per annum during her life. The beneficiary had the right to designate a contingent beneficiary. This was required to be made in writing and filed at the Home Office of the Company prior to the death of the beneficiary. The policy further provided that "at the death of the last surviving beneficiary if there be no contingent beneficiary then living, or at the death of the last surviving contingent beneficiary, the amount retained by the company . . . will be paid to the executors, . . . of the last surviving beneficiary or contingent beneficiary . . ."

The insured died in 1925. The beneficiary died in 1945 without designating a contingent beneficiary. In the beneficiary's will no mention was made of the policy. The residue of the estate was placed in trust. The Commissioner included the insurance proceeds in the gross estate under Section 811(a), I.R.C. (N. Y. Law, Sec. 249-b(a)) and Section 811(b), (N. Y. Law, Sec. 249-b(f)). Section 811(a) provides for inclusion in the gross estate of the value of all property "to the extent of the interest therein of the decedent at the time of his death." Section 811(b) provides for inclusion in the estate of "property with respect to which decedent exercises a general power of appointment. . . ." The District Court entered judgment for the Commissioner and the executor appealed.⁴

⁴ *Second National Bank of Danville, Illinois v. Dallman*, U. S. Court of Appeals, 7th Circuit, January 12, 1954.

The court held that the proceeds passed under the insurance contract and not under an exercise of a power of appointment by the will of the decedent. It held that the decedent had no power of appointment, since none was created. The decedent's powers were in the insurance contract and nothing was done as provided in that contract. For that reason the proceeds were payable under the direction of the insured as contained in the insurance contract. Whatever rights the decedent had under the insurance contract were extinguished by death.

As to Section 811(a) the court held that the decedent-beneficiary had merely the right [to retain the insurance proceeds in *its* possession and the right] to name a contingent beneficiary in the manner provided in the insurance contract. The beneficiary could not have required the insurance company to pay any part of the principal to her. The decedent-beneficiary had no power to direct the course of the insurance proceeds after her death.

Under the law in effect in 1945, failure to exercise a power of appointment created before October 21, 1942, or a complete release of such a power was not deemed an exercise of such power.

It is difficult to reconcile this decision with the joint and survivor annuity cases⁵ which find a testamentary transfer upon the death of the first annuitant even though the first annuitant does not have any power to direct the income after death, such right having been predetermined in the annuity contract.

Estate Tax—Valuation of Series "G" Defense Bonds at Death

A decedent owned at death two unmatured Series "G" defense bonds individually and also a number of similar bonds jointly with another

person. The administratrix included the bonds in the gross estate at their redemption value. The Commissioner determined the value of all the bonds at par value.

"G" bonds are current income bonds. They were purchasable at par and bore interest at 2½% payable semi-annually. The specified interest rate may be secured only if the bonds are held to maturity. The bonds are redeemable before maturity by notice in writing on the first day of any month, but the redemption value is less than the par value, the difference being an adjustment of the interest. Upon the death of an owner or co-owner, the "G" bonds may be redeemed at par before maturity upon written notice given within six months after the date of death of the owner or co-owner.

In a Tax Court case⁶ on this issue the Commissioner was sustained. Said the court, the right to redeem prior to maturity is only one of the incidents of ownership of a "G" bond. Another right that made the "G" bond attractive to investors was the right to redeem the bond at par upon the death of an owner and the par value was properly includible in the gross estate.

Gross Receipts Tax—Taxability of Income from Charter Parties

A corporation with an office in New York City owns a freighter which is turned over to a charterer under a bare boat charter party contract. Under the contract the corporation receives a fixed payment each month for the use of the boat. Is such income subject to tax under the general business tax?

Under Article 249 of the Regulations for the general business tax issued by the office of the Controller, persons doing business within the City of New York who own tangible personal property which is leased to

⁵ *Fidelity-Phila. Trust Co. et al., Executors (Estate of Harry L. Mearkle) v. Commissioner* (1942) 129 F(2d) 386; *Morristown Trust Co., Executors, v. Manning* (1952) 104 F Supp. 625, Affd. 200 S(2d) 1954.

⁶ *Estate of Mary Gandy v. Commissioner*, 21 T. C., No. 26, November 18, 1953.

others, generally are required to report the gross receipts derived from the license to use such property. The extent to which the receipts must be reported is set forth in the regulation.

Where the original situs of the property is within New York City, the receipts are wholly taxable if the property is delivered to lessees within the State of New York. The receipts are allocable if the property is delivered to lessees outside the State of New York but within the United States. The receipts are non-allocable and non-taxable if the property is delivered to lessees outside the United States.

Where the original situs of the property is outside the City of New York, the receipts are allocable if the property is delivered to lessees within the city, and non-allocable and non-taxable if the property is delivered to lessees outside the City whether within or without the United States.

In the facts submitted to us the boat was delivered to the owner, when it was purchased, in the State of Washington and was transferred to the lessee under the charter party at that point.

Under these facts it is our opinion that the receipts would be non-allocable and non-taxable.

There is a further provision in the Regulations that should be noted. Original situs is defined to mean the point at which the property is returned upon termination of the lease, and if there is no established point it would mean the principal office of the taxpayer. In the facts submitted to us the charter party contract provided that upon completion of the contract the boat would be redelivered to the owner at a point to be designated by the lessee. This provision in our opinion would not alter the nature of the receipts as non-taxable and non-allocable.

Franchise Tax—Regular Place of Business

Is the corporation that owns a boat which it has chartered to a lessee en-

titled to any allocation under the franchise tax law? To be entitled to a complete allocation under all three factors a corporation must have a permanent or continuous place of business maintained by it outside the state. Such a place of business is defined in the Regulations (Article 413.2) as any bona fide office, factory, warehouse or other space outside the state which is continuously maintained, occupied and used in carrying on its business through one or more of its regular employees regularly in attendance.

A regular place of business outside the state is an office, factory, warehouse or other space regularly used by a taxpayer in carrying on its business. May a boat qualify as a place of business outside the state? If a corporation that owns a boat itself operates the boat outside New York using its own employees, in our opinion it would come within the definition of a permanent or continuous place of business, the latter being 'other space' on the boat. Under a bare boat charter of the boat to a lessee, the corporation does not use the boat or any space on the boat for its own business and in our opinion would not be permitted even the partial allocation under the property factor.

Franchise Tax—Business Capital

Section 210.1 of Article 9 provides for an alternative tax of one mill on the value of the total business and investment capital. Business capital is defined in the Regulations (Article 332) as the total average fair market value of all the assets exclusive of subsidiary capital or investment capital. In arriving at business capital, current liabilities are deducted from the total assets so that business capital approaches the concept of net assets.

However, not all liabilities are deducted from the total assets. Loans or advances outstanding for more than a year as of any date during the year covered by the report are not deductible. The effect of this provision

(Continued on page 412)

Office and Staff Management

A forum for the exchange of views and information on all aspects of the administration of an accounting practice.

Conducted by MAX BLOCK, C.P.A.

Professional Relations— Losing a client

A keen sense of disappointment naturally results from the loss of a client, particularly when it is not caused by poor service. Nevertheless it is the client's prerogative to utilize the accountants of his own choosing, and the retiring accountant has no choice but to accept the situation graciously. In the course of a year accountants may gain and lose a client or more where other accountants are involved. What, if any, is the professional obligation of the successor?

A talk on this subject is summarized in *The Accountants Digest* (March, 1954; p. 171). Though the remarks are addressed to English accountants they are equally applicable to their American colleagues. The speaker makes the point,

"We may well object to the change in the sense that we do not wish to lose a client. This is irrelevant so far as the proposed new auditor or accountant is concerned. What he wants to know is whether there is any 'professional reason' why he should not undertake the work."

The following additional quotations indicate what is considered proper for the successor to do, and why.

MAX BLOCK, C.P.A. (N.Y., Pa.) is a former chairman of the Committee on Administration of Accountants' Practice of the New York State Society of Certified Public Accountants. He is a lecturer at The City College of New York in the graduate course on Accounting Practice. Mr. Block is a member of the firm of Anchin, Block & Anchin.

"It is essential that the member (practitioner) who is proposed for appointment . . . shall have an opportunity of knowing all the reasons for the change and this requirement can only be fulfilled by direct communication with the holder of the existing appointment.

"Apart from any question of professional courtesy it is important that the legitimate interest of the public and the independence of the existing auditor or professional accountant should be safeguarded and that a communication should take place even though the change is a matter wholly within the discretion of the appointor."

The speaker also pointed out that the existence of unpaid fees should not impose a bar to the acceptance of the appointment inasmuch as that was solely a financial matter that concerned only the parties involved.

Communication with the prior accountant should be at the earliest possible moment, presumably even before the engagement has definitely been accepted. There may, however, be occasions when such rapidity may be difficult and impractical. The "sooner the better" is the rule suggested by the speaker, who further stated the following:

"When the member has considered any information which the existing auditor or accountant may give to him, it is up to him to decide whether to accept nomination, bearing in mind that a client who has decided upon a change is likely to make a change in any event and may well be driven into the hands of an unqualified practitioner if he is not able to get a qualified accountant to undertake the work. The important feature is the duty to communicate. This enables the existing auditor or accountant to give any information which he thinks the proposed new one should have."

Accounting Partnerships

At a recent meeting of the Society's Committee on Problems of Individual Practitioners, one of the speakers delivered a paper advocating the association of accountants in partnerships or other federations, in preference to individual practice. He cited many advantages to such association though it may well create problems of human relationship. Insofar as it was possible to gauge the audience reaction, his remarks were well received.

For the benefit of those who may be contemplating a partnership, attention is directed to Chapter 3 of the C.P.A. Handbook which deals with the subject of Accountants' Partnership Agreements.

Snap-Apart Tax Return Forms

A substantial saving of typists time and improved alignment of figures on tax return copies were reported by several accountants, at a recent luncheon meeting of office managers, from the use of carbon interleaved "snap-apart" tax blanks. These forms, used for federal returns 1040, 1040 S, and 1065 primarily, may be purchased. For office control purposes it may be helpful to have the sets consecutively numbered and one accountant recommended typing the taxpayer's name at the bottom of the snap-out section.

Snap-apart blank forms are also available and are useful in the preparation of supporting schedules. The printed and blank forms are available from certain printers, some of whose advertisements appear in this magazine at times.



New York State Tax Forum

(Continued from page 410)

is to treat long-term liabilities as capital used to finance a business, just like capital stock.

Suppose a corporation buys a boat for \$500,000, paying \$200,000 in cash and the balance by a note of \$300,000 payable monthly at the rate of \$5,000 per month. Is such liability to be deducted in whole or in part from total assets in arriving at business capital taxable under the one mill tax?

Schedule C of Form 3CT shows the computation of capital. Line 10 segregates bonds, notes and mortgages payable into those with *original* maturity of less than one year and those with original maturity of one year or more. The former would be deductible from total assets, the latter would not. The

instructions to Form 3CT state that only liabilities maturing in one year or less from date originally incurred are deductible. And even as to such liabilities, loans or advances outstanding for more than a year as of any date during the year covered by the report are not deductible. Nor are demand notes or notes payable which are regularly renewed from year to year deductible. Applying this to the facts stated above, \$60,000 of the \$300,000 would be deductible from total assets and the balance of \$240,000 would not be deductible. In our opinion it would be proper to consider the first year's payments of \$5,000 per month as liabilities with original maturity of less than one year.

Payroll Tax Notes

Conducted by SAMUEL S. RESS

Withholding of Federal Income and FICA Tax

Pensions and Retirement Pay

The general rule is that pensions and retirement pay are wages subject to withholding. However, no withholding under Code Section 1622(A) is required with respect to amounts paid to an employee upon retirement which are taxable as annuities under Code Section 22(B)(5).

Under the latter section annuity payments received during the taxable year under annuity contracts are included in gross income to the extent of 3% of the aggregate premiums or consideration paid for the annuity until such time as there is full recovery by the purchaser of the total consideration paid. Thereafter, each annuity is taxable in full. The same rule applies when the annuities are payable to the purchaser's widow, child or children. However the annuities are subject to withholding when the beneficiary is a non-resident alien.

Employee's Statement of Wages and Taxes Withheld

Many cases have been reported of requests by employees for cumulative statements with each payment of wages showing the amounts deducted for

federal income and social security taxes withheld from wages with each payment of wages. Employers are not required to give their individual employees such cumulative statements with each payment of wages.

Code Section 1403(A) formerly required an employer with respect to withholding of FICA wages paid before January 1, 1951, to furnish an employee at least quarterly with a statement showing the total amount of wages paid within such period, and the amount of FICA taxes withheld from such wages. The employer had an option to furnish such a statement to any employee at the time of each payment of wages to the employee during any calendar year in lieu of a statement covering a complete quarter.

Under the present law, in Code Section 1633(A), an employer is required to furnish an employee with an annual statement by January 31, showing: the total wages subject to federal income and FICA taxes, respectively, paid during the preceding calendar year; the total amount of FICA taxes deducted and withheld; and the total amount of federal income tax deducted and withheld. This annual statement is made on form W-2.

Surety's Liability to Government for Withholding Taxes Not Paid by Employer

Whether or not a defaulting contractor's surety is liable for taxes which the contractor failed to withhold from his employees' wages, or which it withheld and failed to pay to the government, depends upon three factors: 1. Whether the amounts withheld or which should have been withheld are "wages" so far as the surety contract is involved; 2. the choice of words used in limiting the surety's

SAMUEL S. RESS has been an Associate Member of our Society since 1936, and is also a member of the Bar. He has specialized in the payroll tax field since the inception of this type of legislation in 1936.

Dr. Ress is Vice Chairman of the Society's Committee on Labor and Management and a member of its Committee on State Taxation.

liability for taxes; 3. whether the surety has replaced the contractor as the employer.

A surety was held not liable for taxes which the contractor had withheld from the wages of his employee but did not pay to the government. (*United States Fidelity & Guaranty Co. vs. U. S.*, Tenth Circuit Court of Appeals, 1953).

For purposes of withholding of tax on wages, Code Section 1621 (d) defines the term "Employer" as the one for whom the individual performs services. It also provides that if a person for whom the individual performs or performed services does not have control of the payment of wages for such services, the term "Employer" will generally mean the person having control of the payment of such wages. However, advances by a person for whom work is done, does not necessarily make him an Employer.

Recent New York State Unemployment Insurance Decisions re: Vacation Closing of Plants

In a recent case, *Matter of Naylor* (281 App. Div. 721, affirmed by the Court of Appeals, March 4, 1954), it was held that where an Unemployment Insurance claimant was a member of

a Union whose agreement with the Employer provided for a vacation period during which the plant was closed down, the claimant was deemed to have voluntarily withdrawn from the labor market during the vacation period and consequently was not entitled to collect Unemployment Insurance benefits during the period of the vacation shut-down. Another decision which reached the same conclusion involved a group of employees who were not entitled to vacation pay. The Appeal Board in case #43,004-54 held that any contention that the claimants, who were not entitled to vacation pay, were willing to continue working for the Employer or to work elsewhere during the shut-down period cannot be accepted. Since it had been shown that the Union has consented to the shut-down of the plant for vacation purposes, it follows under the *Naylor* decision that there was a temporary and voluntary withdrawal from the labor market of all the employees in the bargaining unit covered by the agreement and affected by the shut-down, regardless of their right to vacation pay. The Appeal Board concluded that these individuals were properly denied Unemployment Insurance benefits by the Employer during the vacation period established under the collective bargaining agreement.



New Accounting Journal

The South African Accountant (*Die Suid-Afrikaanse Rekenmeester*), a new quarterly, whose initial issue appeared in March, 1954, is published by the Public Accountants' and Auditors' Board, Johannesburg, South Africa, at an annual subscription rate of £1.

"The History of the Profession in South Africa", "The Auditor and the Recent Amendments to the Companies Act", and a

paper in Afrikaans, were the principal articles in the first issue.

The magazine also contained a foreword by the Chairman of the Public Accountants' and Auditors' Board. A section on taxation, a "Commentary on Published Accounts" (reports), "Legal Notes", a "Students' Section", a book review division called, "For the Accountant's Bookshelf", "Announcements", and a number of "Personal and Professional Notes" made up the remainder of the issue.



OFFICIAL DECISIONS and RELEASES

NINETEENTH ANNUAL REPORT

of the

SECURITIES AND EXCHANGE COMMISSION

(Fiscal Year Ended June 30, 1953)

Section Dealing with the Activities of the Commission in Accounting and Auditing

The several Acts administered by the Commission provide that dependable, informative financial statements, which disclose the financial status and earnings history and potentialities of a corporation or other commercial entity, shall be made a part of registration statements, applications for registration, and periodic reports required to be filed with the Commission.

The Acts administered by the Commission and rules adopted thereunder provide that the financial statements required to be filed with the Commission shall be certified by independent public accountants. The value of certification by qualified accountants has been conceded for many years, but the requirement as to independence, long recognized and adhered to by some individual accountants, was for the first time authoritatively and explicitly introduced into statutes. Out of these provisions and the administration thereof by the Commission there have grown concepts of accountant-client relationships that have strengthened the protection afforded investors.

The Commission has prescribed uniform systems of accounts for companies subject to the provisions of the Holding Company Act,¹ has adopted rules under the Securities Exchange Act governing accounting and auditing of securities brokers and dealers, and has promulgated rules contained in a single, comprehensive regulation, known as Regulation S-X,² which govern the form and content of financial statements filed in compliance with the various Acts. These regulations are implemented by the Accounting Series releases, of which about 75 have been issued, designed to make public from time to time opinions on accounting principles for the purpose of contributing to the development of uniform standards and practice in major accounting questions. The rules and regulations thus established, except for the uniform systems of accounts, pre-

scribe the accounting to be followed only in certain basic respects. In the large area not covered by such rules the Commission's principal reliance for the protection of investors is on the determination and application of accounting principles and standards which are recognized as sound and which have attained general acceptance.

Changes and new developments in financial and economic conditions affect the operations and financial status of the several thousand commercial and industrial companies required to file statements with the Commission. The Commission, therefore, must be informed of changes and new developments in these fields and must make certain that the effects thereof are properly reported to investors. The Commission's accounting staff therefore engages in study and research designed to establish and maintain appropriate accounting procedures and practices. Furtherance of these activities requires constant contact and cooperation between the staff and accountants both individually and through such representative groups as, among others, the American Accounting Association, the American Institute of Accountants, the Controllers Institute of America, and the National Association of Railroad and Utilities Commissioners, as well as other governmental agencies.

During the year the Commission found it necessary to give consideration to a change in procedure recommended by the American Institute of Accountants with respect to the accounting for options granted by corporations to their employees and officers to purchase stock of such corporations. These option arrangements, which have been adopted by an increasing number of industrial companies filing financial statements with the Commission, are found in a variety of forms. While some of the plans have given the optionees the un-

¹ *Uniform System of Accounts for Mutual Service Companies and Subsidiary Service Companies* (effective August 1, 1936); *Uniform System of Accounts for Public Utility Holding Companies* (effective January 1, 1937; amended effective January 1, 1943).

² Adopted February 21, 1940 (Accounting Series release No. 12); revised December 20, 1950 (Accounting Series release No. 70).

The New York Certified Public Accountant

restricted right to exercise the options immediately, others have required that the optionees remain in the employ of the company for a specific period before they have the unrestricted right to exercise the options, and still others have been granted the right to purchase a specified number of shares each year over a period of years provided the optionees are in the employ of the company upon each such option date.

Prior to 1950 many of these plans fixed the purchase price at substantially less than the market price of the stock optioned at the date the option was granted. Because of the change in the income tax law in 1950 with respect to the taxability of optioned stock, many corporations have changed their methods of granting options. Some of the plans adopted since that date continue to set the option price at varying amounts under the market price, but in most instances the option price is substantially the same as market.

The fact that such plans afford benefits to the participating employees which are susceptible of monetary expression has been recognized in court decisions and in the varying treatments which have been accorded such options under the Internal Revenue Code. Under these circumstances the Commission has required financial statements filed with it to reflect amounts corresponding to the benefit to the optionees as charges against income of the issuer in the period or periods in which the optionees first obtained the unrestricted right to exercise their options, a procedure concurred in by the accounting profession, as indicated by Accounting Research Bulletin No. 37, issued in November 1948 by the American Institute of Accountants. As of a recent date this bulletin was revised to indicate that the date on which an option is granted is the date that should be used in determining such compensation and that the amount of compensation to be recorded in the accounts of the corporation should be the excess of the fair value of the optioned stock over the option price as at that date.

In view of the revision of Accounting Research Bulletin No. 37, the Commission deemed it necessary and appropriate to give consideration to the adoption of a rule re-

quiring a corporation which grants options to its officers and employees to acquire its capital stock, thereby incurring costs in the form of compensation to the optionees, to account for such costs, at the time the optionees have complied fully with the terms of the option, by charging corporate income with an amount equal to the fair value of the stock over the option price at that date. This would continue in effect the procedure the Commission had required in the past.

The Commission announced its intention of promulgating such a rule in a public release and invited all interested persons to express their views thereon. After further consideration of the question in the light of the comments received the Commission deemed it inappropriate to prescribe a procedure for determining the amount of cost, if any, of these stock options to be reflected in profit and loss or income statements filed with the Commission. However, in order that investors may be apprised of the monetary significance of the concessions made by registrants to officers and employees through the granting of stock options, the Commission, on November 3, 1953, adopted rule 3-20 (d), to be added to Regulation S-X, which requires full and complete disclosure of all stock option arrangements in financial statements filed with the Commission.³

During the fiscal year the Commission issued its Findings, Opinion and Order in a proceeding instituted under rule II (e) of its Rules of Practice against Haskins & Sells, a firm of certified public accountants, and Andrew Stewart, a partner in that firm. The Commission found that respondents had failed to devote the care and inquiry required by the circumstances in connection with the preparation and certification of balance sheets for use in a registration statement filed by Thomascolor, Incorporated, grossly overstating intangible assets and attributing to apparently potentially productive items material amounts which should have been shown as promotion services. The Commission concluded that it was necessary to deny respondents the privilege of practicing before the Commission for a period of ten days.

³ Accounting Series release No. 76.

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